







## **COMPANY FINANCE**



# Company Finance

BY

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## INTRODUCTION

THE origin of this book was a course of lectures delivered to the students of the City of London College. The lectures were delivered from the barest of notes, and the book, in consequence, differs both in scope and phrasing from the spoken word. But it does embody the experience gained by the lecturer of what students of finance really want to know in their early years.

A volume of this modest size cannot pretend to do more than sketch the ground covered by its ambitious title. Its merit, if it has merit, must be sought in its mixture of theory and practical experience. Its use should be that of a handbook rather than a textbook. It may serve as a useful introduction to larger books on finance, of which there are many, including one or two from my own pen.

I wish to acknowledge, with thanks, the permission readily accorded to me by the Committee of the London Stock Exchange to reprint as an appendix their rules covering "permission to deal." This and the sections and schedule of the Companies Act, 1929, covering prospectuses (also given as an appendix) will, I trust, be particularly useful in this accessible form to those whose private companies are approaching the point of conversion to public companies.

C. B.



## CHAPTER I

### THE DEVELOPMENT OF COMPANIES

THE economic system under which the modern joint-stock company flourishes has come to its present form—or to its present moment of flux—by a long process of evolution. The law which defines the rights and obligations of joint-stock companies, which limits their means of obtaining finance and largely governs the uses which can be made of that finance, is also the product of a long evolution. Company practice will be much more readily and thoroughly comprehended if the history of the financing of industry and of enterprise is first mastered, in outline if not in detail.

Neither accepted practice nor established law is the result of accident or haphazard experiment. Both are the fruit of empiric knowledge. A man may—and many men do—successfully manage the financial affairs of a company without any very profound knowledge of economics, but even a superficial knowledge of economic history is an aid to successful management. In the work of forecasting, which is a vital part of the task of a finance director, some knowledge of economics is essential. Henry C. Emery, discussing "Speculation on the Stock and Produce Exchanges of the United States" as far back as 1896 quoted with approval Professor Hadley's dictum that "the success or failure of a man engaged in manufacturing, in transportation, or in agriculture, depends more upon his skill as a prophet than upon his industry as a producer." With that dictum few engaged in modern business will quarrel. It justifies the spending of some little time upon a history of concerted enterprise and the development of companies before an

examination of the financial structure and technique of contemporary companies is made.

For our knowledge of the early capitalisation of industry we are thrown back upon that "conjectural history" which Walter Bagehot despised so thoroughly. Written records have not survived for the simple reason that they were never there to survive. It is possible from a chronologically advanced but relatively remote stage of civilisation to recover accounts of ecclesiastical or military communities, and from them to make valuable economic and sociological deductions. Historians of the temper of Mr. Belloc may even extend those deductions to enlighten us upon such problems as the pace at which an army must have marched or the terrain which it must have occupied. But in the earliest stages of communal effort to increase wealth by industry and exchange no surviving records were kept.

We can with safety assert that primitive companies of men engaged upon some joint enterprise were either communal or patriarchal.

It is no idle confusion of terms which causes men of business to regard "capital" as money, even though the textbooks of economics teach that capital is the things over which money has command, that money is but the symbol of capital. The most illuminating definition of capital is "the power to wait." It is just this power to wait which finance gives to an enterprise.

In the early conjoint efforts to till land or to adventure upon the seas for trade or loot, the power to wait was obviously derived either from a pooling of some common stock of goods that kept the venturers alive until their enterprise fructified, or from a stock held by some powerful personage in the group. Conjectural history to this extent is palpably sound, because the method has never changed, no matter how complex industry has grown. What *has* changed is the width of the commune which ventures its joint stock of goods and the remoteness from the original seat of enterprise of the person who, in default of a common stock, provides sustenance and equipment until the venture thrives.

There has also appeared, since the primitive days, a functionary whose business it is to link potential venturers to a source of capital. This functionary varies in kind, but he will be recognised as performing the same function whether he be banker, stock-broker, company promoter, or "finance house."

As soon as a company of men either produces more than its members desire to consume or embarks upon some kind of production which takes time—as the sowing of a crop for delayed harvest or the breeding of some animal with a long gestation period—the need is felt either for a factor or for a financier, or possibly for both. A factor is one who buys and sells goods for another, but who does so in his own name and has possession of the goods in which he deals, with a lien on them as security for his charges. A financier, as the name implies, is one who supplies finance, that is, who supplies the means of livelihood while the delayed production is coming into being or even supplies the means of production. Every simple textbook of economics stresses the early relations that are thus established in the most primitive forms of exchange. Even in communities where no money exists the sharing of goods or implements by producers and their attached functionaries—carriers, factors, store-keepers, or whatnot—involves what we to-day, in money-using communities, would call financing.

In very early settlements the easiest form of enterprise is that of the family or that of the partnership. Those forms of enterprise are such where all venture all. They exist to this day. The easiest modification of such an enterprise is the admission to it of someone who is not prepared to venture all, but is prepared to venture something—the person who is known in law as a "limited partner."

The difference between a limited partner and an associate who has merely lent something that must be repaid is slight. It is the difference between a share in profits and a rate of interest.

With very few exceptions, every enterprise that is

launched begins to take credit from those about it, or to give credit. Either it borrows means of working or it requires things for which it is not ready to give its own product in exchange. If the enterprise includes a number of persons, all must be tied by the actions of those representing them. The enterprise, as such, begins a life of its own with special relations of its own to the community about it, but if those relations lead to unpayable debt the community is right in looking to all concerned in the venture (and in the possible profit of the venture) for its recoupment.

If two men borrow a plough the lender is right to expect either the return of his plough or its value. If two men buy a plough, the vendor is right to expect its value. While the borrowers (or buyers) have the means to pay him he is guilty of no extreme avariciousness in claiming his due. It is nothing to him if the ploughing has been a failure.

Similarly, if a group of men borrow or hire money, the lender has a right to a repayment, either in money or goods, if the borrowers have possessions that can be transferred. It is nothing to him that the use of the borrowed money has been unfruitful.

From the very dawn of industry there must have been present, although not always recognised, a series of vital distinctions. In any enterprise there were certain men who were buyers or hirers of capital (whether in goods or money) and others who were lenders or sellers. And there were among them men who appeared to act in both capacities at once. Thus William and Walter who joined together to till a plot of land, might first enlist the assistance of John and then buy a plough from James. To James the combination of William, Walter and John might seem a triple partnership, and he would feel that he could pursue his claim against them for payment indiscriminately. But John would regard himself not as in association with William and Walter, but with James. He would even feel that he had a prior right to possess himself of the goods of William and Walter if they failed to pay for the plough or return him his money.

Those early distinctions of relationships have with time been clarified and socially and legally recognised.

To-day we have providers of capital (that is, finance) who are openly debtors for anything for which they may contract.

We have providers of capital (that is goods) who are creditors.

Not until very recent times could the providers of capital who were openly debtors for anything for which they might contract limit their liability as debtors. For generations their responsibility for the debts they contracted in one capacity was borne by them in every capacity.

How the change came is worthy of study.

We need not trace the long history of primitive industry and trading merging into more complicated industry and trading. It is sufficient to realise that as matters grew more complex the relations of enterprises to the State and the community also grew complex, and came more and more under regulation. For some generations there existed in England the Courts of the King, which administered the common law, the Feudal Courts, which enforced the local customs of the fief, the Ecclesiastical Courts, and the Courts Merchant, which administered the *law merchant*. Not until Lord Mansfield obtained his remarkable dominance of his legal colleagues and pushed forward the work begun by Sir John Holt was the *law merchant* incorporated with the common law. J. M. Rigg (in the *Dictionary of National Biography*) says of Mansfield's work of "moulding the law into accordance with the needs of a rapidly expanding commerce and manufacture" that he "thus converted our mercantile law from something bordering upon chaos into what was almost equivalent to a code."<sup>1</sup>

Mansfield's work was done in the 1780's. Adam Smith, writing a decade earlier, had described the kinds

<sup>1</sup> Readers who wish to follow this subject further will find useful and interesting *The Book of English Law*, by Professor Edward Jenks—Chapter Two, "The Origins of English Law."

of company with which the country and the law were then familiar. There was the Regulated Company.

The regulated companies for foreign commerce [writes Adam Smith] which at present subsist in Great Britain, are the ancient merchant-adventurers company, now commonly called the Hamburg company, the Russia company, the Eastland company, the Turkey company and the African company. . . . Regulated companies resemble, in every respect, the corporation of trades, so common in the cities of Europe; and are a sort of enlarged monopolies of the same kind. . . . The usual corporation spirit, wherever the law does not restrain it, prevails in all regulated companies. When they have been allowed to act according to their natural genius, they have always, in order to confine the competition to as small a number of persons as possible, endeavoured to subject the trade to many burdensome regulations. When the law has restrained them from doing this, they have become altogether useless and insignificant.

These regulated companies were, in short, trade guilds, with apprenticeship and strict rules of admission.

The second kind of company then flourishing was the joint-stock company. Smith's description remains apt to-day.

Joint-stock companies, established either by royal charter, or by act of parliament, are different in several respects, not only from regulated companies, but from private co-partneries.

First, in a private co-partnery, no partner without the consent of the company, can transfer his share to another person, or introduce a new member into the company. Each member, however, may, upon proper warning, withdraw from the co-partnery, and demand payment from them of his share of the common stock. In a joint-stock company, on the contrary, no member can demand payment of his share from the company; but each member can, without their consent, transfer his share to another person, and thereby introduce a new member. The value of a share in a joint stock is always the price which it will bring in the market; and this may be either greater or less in any proportion, than the sum with which its owner stands credited in the stock of the company.

Secondly, in a private co-partnery, each partner is bound for the debts contracted by the company, to the whole extent of his

fortune. In a joint-stock company, on the contrary, each partner is bound only to the extent of his share.

The trade of a joint-stock company is always managed by a court of directors. This court, indeed, is frequently subject, in many respects, to the control of a general court of proprietors. But the greater part of these proprietors seldom pretend to understand anything of the business of the company; and when the spirit of faction happens not to prevail among them, give themselves no trouble about it, but receive contentedly such half-yearly or yearly dividend as the directors think proper to make them. This total exemption from trouble and risk, beyond a limited sum, encourages people to become adventurers in joint-stock companies, who would, upon no account, hazard their fortunes in any private co-partnery. Such companies therefore, commonly draw to themselves much greater stocks than any private co-partnery can boast of. The trading stock of the South Sea company at one time amounted to upwards of thirty-three millions eight hundred thousand pounds. The divided capital of the Bank of England amounts at present, to ten millions seven hundred and eighty thousand pounds. The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

A condition where the negligence and profusion of a few men might bring complete ruin upon those who had entrusted their surplus funds to such laggards and spend-thrifts for investment naturally limited investment. At a time when the growth of machinery and the speeding up of transport and the migration of energetic citizens to all parts of the world was making the need acute for larger and larger pools of capital, this possibility of complete ruin from a chance investment was retarding development.

While it was becoming more and more apparent that

some change in the law would have to be made if companies were to attract the amount of capital they needed from wider and wider circles of investors another factor was also at work.

The law was, as usual, laggard and stupid. The law, in fact, was "a ass." Companies incorporated by royal charter it knew and would tolerate and protect and regulate. But when companies which were unincorporated were formed the law insisted upon regarding them as ordinary partnerships. In a chartered company the members were under no liability for the debts of the corporation, for the Crown had no power at common law to attach liability to the individual members. Blackstone's *Commentaries* are specific: "The debts of a corporation either to or from it, are totally extinguished by its dissolution; so that the members thereof cannot recover, or be charged with them, in their natural capacities."

By the early nineteenth century there were two kinds of company in existence—the chartered company (an incorporated company) and the unincorporated company, with a third, rather hybrid type, the company incorporated by special Act of Parliament.<sup>1</sup>

The unincorporated company, as I have said, was regarded by the law as a partnership, but between a partnership and a company there is an enormous difference. That difference was admirably defined by Lord Justice James in 1880, when he said:

An ordinary partnership is a partnership composed of definite individuals, bound together by contract between themselves to continue for some joint object, either during pleasure or during a limited time, but the partnership is essentially composed of the persons originally entering into the contract with one another. A company or association, which I take really to be synonymous terms, is an arrangement by which parties intend to have a partnership which would be constantly changing; that is to say, to have what I may call a succession of partnerships, a partnership to-day consisting of certain members, but to-morrow consisting of some

<sup>1</sup> These grew out of the canal-construction movement: railway and other utility companies are the best examples.

of those members only and some others who have come in. Here there will be a constant shifting of the partnership, a determination of the old, and the creation of a new partnership, formed with a view and always formed with the intent, so far as the members can by agreement between themselves, of binding the next partnership to take upon itself the assets and debts of the old partnership. This object could not be effected in point of law by any arrangement between the persons themselves, unless the persons contracting with them by a novation authorised the change; or unless it was by special provisions to such arrangements and to a certain extent, and under certain circumstances, have allowed that to be effected. That is the sole distinction between association and partnership.

But between the seventeenth and the early nineteenth centuries this difference was not fully grasped. Palmer, in his *Company Law* discussing unincorporated companies constituted by contract, makes the position very clear:

These companies made their appearance first in the seventeenth century. It was a time when men of business were beginning to recognise the advantages derivable from co-operation in commercial enterprise, the advantages which it offered, that is to say, on the one hand for raising funds for the purposes of large and more or less speculative undertakings by means of contributions from a number of small capitalists ready and willing to co-operate, and on the other hand of minimising the risk by spreading the liability. The difficulty was how to secure these advantages. A charter was too costly, and a special Act of Parliament was impracticable. Business men had to devise for themselves a new form of partnership which should possess the advantages as nearly as might be of a chartered corporation, and in particular should have shares of fixed amount freely transferable by the holders. The outcome of these commercial needs was the unincorporated company, the lineal ancestor of the ordinary company under the Companies Act, 1862, and its amending Acts, now reproduced and consolidated in the Act of 1929.

The law at first frowned on these new associations. It questioned their validity. It insisted on treating them as ordinary partnerships, and by this and other rules which it applied to them seriously checked and crippled their development. They continued, however, to be formed, and gradually the number increased until the fraudulent promoter appeared on the scene.

To such an extent did this person take advantage of the opportunity by floating all sorts of fraudulent and objectionable concerns that the legislature had, in 1719 to intervene and pass the Bubble Act with a view to putting down fraudulent companies. Unfortunately the Act was expressed in such ambiguous terms as to raise doubts whether it was not intended to stop generally the formation of companies with transferable shares, good and bad alike. . . . The difficulty was solved, however, in 1825 by the repeal of the Bubble Act, and thenceforth, for a time, the formation of companies was left to the common law, subject to the doubts which existed as to whether, under the common law, they were legal or not, doubts which were subsequently settled in favour of their legality. . . .

Left to the freedom of the common law, the tide of company enterprise rose, and, as it did so, the policy of the legislature changed. In lieu of the policy of repression the legislature, in 1844, recognising the advantages of the joint-stock company principle, and the desirability of facilitating the association of persons in commercial undertakings, provided means for regulating them by passing, in 1844, the Act 7 & 8 Vict c 110. This Act, with certain exceptions, required all companies subsequently formed to be registered under it. The formation of unregistered companies was thus, to a great extent, stopped, and though the Act was repealed in 1862, except as to then existing companies, the Acts of 1862 and 1908, continued to prohibit the formation of unregistered companies for gain where the numbers exceeded twenty, or in the case of banking companies, ten. The Act of 1929 does the same.

It was not, however, until 1862 when the Companies Act of that year (by common consent one of the greatest achievements of British legislation) was passed that limited liability was open easily to all who wished to form a company to carry on an enterprise. The Act had one central principle—to make the formation and the working of the company easy and at the same time to indicate to all who had dealings with it that the liability of its members was limited. Seven signatures to a written or printed memorandum of registration, the payment of a fee and the inclusion of the word "Limited" in the title, and the thing was done.

This Act was amended by no fewer than eighteen

Statutes between its passing and 1908, and since then we have had the abortive Companies Act of 1928 and the active Act of 1929, but the principle is unchanged.

When limited liability thus became so easy an attainment it would have been thought that all would have hastened to secure it. It was not so. The progress of the limited liability principle in Britain is really due to an appalling financial catastrophe which happened in Scotland in 1879. This was the failure of the City of Glasgow Bank and the trial of its directors.

A contemporary account of the trial, now hard to obtain, opened its pages with this "prefatory note":

The trial which has now terminated, and of which, in the following pages, we present a full and authentic Report, will in all probability rank as the most important which has ever taken place in Scotland. Whether regard be had to the magnitude of the distress occasioned by the collapse of the City of Glasgow Bank, the social position of the directors who managed, or rather so grossly mismanaged the concern, the disclosures which followed the preliminary investigation of its affairs, or the startling character of the evidence disclosed by witnesses for the Crown, no other great trial at all approaches it in permanent interest. The facts presented in these pages will long be regarded as a standing memorial of unparalleled commercial disaster—disaster brought about not by innocent misfortune, but by the culpable recklessness of gentlemen moving in the highest social and commercial, not to say religious, circles, in whose honour and integrity many thousands of their countrymen had for years placed the most unbounded confidence—how they, step by step, converted a great banking institution into a mere machine for abstracting money from the pockets of a too confiding public, in order that it might be lavished upon their friends, and that the credit of utterly rotten mercantile houses might be upheld, and their principals allowed to revel in luxury, when in reality they were penniless bankrupts—all this may be seen in the evidence which we have detailed, in the speeches for the prosecution and defence, and in the clear and masterly summing-up of the Lord Justice-Clerk.

It may be of interest, in this connection, briefly to recapitulate the chief facts with the history of the City of Glasgow Bank, which has thus had such a deplorable termination. The Bank was established in 1839. Having its head office in Virginia

Street, Glasgow, it carried on no fewer than 133 branches. The partnership numbered 1,249; and the paid-up capital was £1,000,000 sterling. In November 1857, the bank, succumbing to the heavy run occasioned by the failure of the Western, was obliged to suspend payment; but after the panic ceased, it resumed business. The bank has since gone on with results which, up to the 2nd of October last, had maintained its stock at the high figure of £240 per £100 share; and so recently as July last, when a dividend of 12 per cent. was declared, the directors submitted a statement of the bank's affairs, showing that it possessed unimpaired a reserve fund of £450,000, and that it had earned a profit of £140,095 12s. 10d.

Notwithstanding this apparent prosperity, the bank found it difficult to carry on its business. In London, its acceptances were being refused; its credit in many quarters was more than suspected; and the directors began to make desperate efforts to obtain help, and prevent the bubble from bursting. As a last resource, they applied for assistance to the other banking companies; but the latter having obtained a report from Mr. Auldjo Jamieson, C.A., to the effect that an examination of the books showed a worse state of matters than had been represented, the request was refused. The directors of the City of Glasgow Bank, in these circumstances, had no alternative but to close their doors, which, as already stated, was done hastily on the morning of the 2nd October 1878.

A Committee of Investigation having been appointed, liquidation was, on their recommendation, resolved upon at a meeting of the shareholders, held in the City Hall, Glasgow, on 22nd October. Subsequently, the liquidation was ordered to proceed under the supervision of the court.

The report of the Investigation Committee, which was published in the newspapers of the 19th October, brought out the startling fact, that the deficiency, including the bank's capital and reserve, amounted to no less a sum than £6,190,983 11s. 3d. This fact had not been made public for many hours, before, at the instance of the Lord Advocate and the Procurator-Fiscal for Lanarkshire, a warrant was obtained for the apprehension of the manager, secretary, and directors. The arrests were quietly effected in Glasgow and Edinburgh on Saturday evening, October 19, and on Monday they passed the bar of the Police Court, and were remitted to the Sheriff on a charge of fraud. Subsequently the prisoners were lodged in Duke Street prison, where, under

the new Act applicable to untried prisoners, they were allowed to maintain themselves, at their own expense, in comforts unusual in a prison. On the 29th, they were further charged with the theft of bills left for collection to the amount of £20,000, and were then formally committed for trial. Subsequently, Mr. John Stewart was released on a bail-bond for £15,000. After a full debate before the Court, bail was refused in the case of the other prisoners; and, with the exception of Mr. Leresche, the secretary, who was released at the instance of the Crown, and who afterwards became a witness for the prosecution, they remained in Duke Street prison till the morning of Thursday, 16th January, when they were removed to the Calton Jail of Edinburgh, to await their trial, which began on Monday, 20th January, and terminated, with a unanimous verdict of Guilty, on Friday, 31st January. Sentence was pronounced on Saturday, 1st February.

That contemporary writer's estimate of the importance of the trial has not been rebuffed by time. The trial was and is important, for it was the wide-spread ruin caused by the failure, the knowledge that beneficiaries of trusts who were unaware even of their holdings in a public company might be brought to penury by its collapse, that drove home to the public imagination the importance of the limited liability principle of the Act of 1862.

In our time the principle is so universally used and has become so familiar that few people think of any company that is not limited in this way.

Limited liability as a principle has had a remarkable effect upon the social development of the community. It has made not only possible but inevitable the divorce of the ownership of capital from its control. It has given rise to many social and political anomalies. As I have said in *The Economics of Human Happiness*:

The need was for large and widespread capital contributions to enable large and wide-flung markets and sources of supply to be exploited by expensive plant and manifold departments of man-power. Limited liability catered for this need, but created a growing divorce between the owners of an enterprise and its direction. It also changed the attitude of those owners towards the enterprise, for it concealed responsibility. Estimable men and women could engage in dubious businesses or businesses conducted

in a dubious way without their knowing it, and without their neighbours knowing it. The stigma of dishonourable trading was not upon them. To give an extreme example, the wife of a Nonconforming minister who would have died rather than help to finance a brothel in her own township might draw dividends without shame from some remote property enterprise which made its high returns from renting apartments to bawds or harlots in distant towns, or even in her own town.

As the great labour organisations grew in numbers and power they naturally accumulated surplus funds which they were storing against some desperate need. Those funds they could not leave idle. The effect of limited liability having been to expand enormously the number of companies and to extend enormously the number of investors, the Stock Exchange was naturally the focal point for the attention of trade union officials charged with the duty of wisely placing the surplus funds until they were wanted. The active market in shares assured the placers of immediate liquidity when the need arose for other use, and also promised a reasonable income on the invested funds. The motive of those officials in investing the money was very rightly the usual commingled motive of a desire for a return and a desire for safety. There thus came a time when the money of one union was invested in the enterprises to forward which men of other unions labored. This created a very ironical state of relationships.

The directors of an enterprise, knowing that its power to attract new capital for further expansion depended upon their showing an attractive return to the capital already invested, thought first of profit, and in making a profit costing is all-important. A vital factor in costs being labour costs, the directorial endeavour was of necessity to keep wages low. If adequate dividends were not paid, the shares of the enterprise would fall in the open market, and holders would sell before their losses became greater. This would prevent the raising of further capital on reasonable terms. The members of the great and small unions and the small savers who had invested thus became the instrument of oppressing their fellow-workers in other industries. It could even happen that a trade union member was all unwittingly one of the factors making for the sweating of himself.

With that description of the sociological effects of limited liability I have still no quarrel. But, for good or ill, the principle is an integral part of our economic civilisation,

and it is as the servitors of limited liability companies that most of us have to handle finance. It is because of the almost century-old usage of the principle that company law has grown with each amending Statute more and more complex, until those who are in charge of finance must now first ask themselves what financial policy they would like to adopt and next assure themselves that such a policy is legally permitted.

To anyone beginning the study of company finance for the first time, the mastery of the latest Companies Act is essential. Its provisions will frequently affect the statements to be made later in this book, but no excerpts or expositions at second-hand can hope to better a first-hand knowledge of its provisions. Both in the raising of finance and its use, the Act limits, directs and controls business actions.

With this sketchy, but probably too lengthy, preamble on the growth of companies, we can turn our attention to the real business in hand, and begin a consideration of company finance by examining what manner of companies the law to-day permits and how they are formed and function.

#### NOTE TO CHAPTER I

THE growth of companies since the Act of 1862 will give some indication of how universal their use has become.

I am indebted to Messrs. Jordan and Sons, the registration agents, for an analysis of the figures.

After the passing of the Act many companies with substantial capitals were registered, the registrations increasing gradually until 1865, when the number of companies registered in England reached 954 with an aggregate capital of £198,709,007, but by 1868 the number had dropped to 420 with an aggregate capital of £34,094,542.

After the Glasgow Bank failure the upward tendency was stimulated.

In 1913, 6,871 companies were incorporated, representing a capital of £146,752,553.

The war years, 1914 to 1918, inevitably decreased the number

*of registrations, but, even so, there was an increase of some 2,000 in the number of companies on the register.*

In 1919, 9,820 (including 9,709 private companies) were registered and in 1920 10,087 (9,581 private) were registered, the aggregate nominal capitals being £384,133,661 and £559,299,697 for the two respective years.

In 1921 the position was affected by the raising of the Capital Duty (payable on registration) and in that year 6,402 (5,889 private) companies were registered with an aggregate nominal capital of £99,107,785. The duty had moved from 5s. per £100, to £1 per £100, which accounts for the drop in the capital figure.

By 1926 the position had recovered, and 7,797 (7,295 private) companies were registered that year with a capital of £203,498,414.

The capital duty was reduced to 10s. per cent. by the Finance Act, 1933.

In 1934, 13,066 companies were registered with an aggregate capital of £148,029,517.

The number of concerns registered to December 31st, 1934, was 130,455 with an aggregate capital of £5,547,350,147. The number of companies registered to December 31st, 1937, was 152,170 with an aggregate capital of £5,895,850,003.

## CHAPTER II

### KINDS OF COMPANIES

THE formation of a company in Great Britain is under the rigid rulings of the Companies Act of 1929, which consolidated or incorporated the various Companies Acts which had preceded it. The Act received the Royal Assent on May 10th, 1929. It had behind it a somewhat singular history.

In the August of 1928 a Companies Act had become law—consisting of 118 sections and three schedules—but had immediately become a dead letter. Only one section (92) was made effective, that prohibiting the hawking of shares. The remainder were to become operative on the passing of an Order in Council, but it was generally understood that no such Order would be made. Another Act, consolidating the old Act of 1908 and the new Act of 1928, was to be speedily passed, and this Act, the Companies Act of 1929, was pushed through its final stages in time to reach the Statute Book before the dissolution of Parliament in 1929. It became operative in the November of that year.

The law to-day recognises two kinds of company—the Public Company and the Private Company. Those two kinds have several sub-varieties, which divide companies into five classes. These are:

- (1) Companies limited by shares, in which the liability of the members is limited to the amount unpaid on the shares held by them.
- (2) Companies limited by guarantee and having a share capital, in which the members, in addition to being liable in respect of such amount as they have undertaken in the company's memorandum to con-

tribute to the assets on winding up, are also liable for any amount unpaid on their shares.

- (3) Companies limited by guarantee and not having a share capital, in which the liability of members is limited to the amount which they have undertaken to contribute to the assets on winding up.
- (4) Unlimited companies, in which there is no limit placed on the liabilities of members.
- (5) Associations not for profit. These may be registered where the object of the formation is the promotion of some useful public aim—art, science, religion, commerce or charity. In such cases the word "Limited" is not required to be the last word of the name of the company.

It will be realised that the process of forming a company is different from the process of floating a company. With flotations we shall deal shortly. For the moment let us examine briefly how a company is formed.

The incorporation of a company is achieved by the filing of certain documents with the Registrar of Companies.

These documents are:

1. Memorandum of Association.

This is virtually the charter of the Company. It must contain clauses stating:

- (1) The name of the company with Limited as the last word.
- (2) The situation in the United Kingdom of the registered office of the company.
- (3) The objects of the company.
- (4) That the liability of members is limited.
- (5) The amount of the share capital with which the company is registered, and the division thereof into shares of a fixed amount.

(These items differ in a company limited by guarantee.)

2. Articles of Association—unless Table A of the

Companies Act (see Appendix) is adopted in its entirety, an alternative only possible to a public Company.

The Articles of Association are the by-laws which regulate the internal affairs and economy of the company. The Companies Act 1929 contains a model set, known as "Table A." With a public company this set may be adopted in its entirety, adapted to special needs, or completely ignored. The Memorandum and Articles generally empower the Company to act in ways not actually contemplated as within its sphere of business, to permit of changes of growth. Certain provisions are barred by law, such as a clause empowering the company to buy its own shares, or a clause extending the powers conferred by the Memorandum or one affecting the rights of certain classes of shareholders.

3. Statement of nominal capital.
4. Declaration of compliance with the requirements of the Companies (Consolidation) Act.
5. Notice of the situation of the registered office.
6. Particulars respecting directors.

(5 and 6 may be filed either at the time of incorporation or shortly after. The Declaration of Compliance must be made either by a solicitor engaged in the formation of the company or by a person named in the articles as director or secretary.)

All these documents are needed whether the company be public or private. A public company requires to file these additional documents.

7. Consent to act as director.
8. Contract by directors to take and pay for qualification shares (when not signed for in the Memorandum).
9. List of persons who have consented to act as directors.
10. Prospectus or Statement in lieu of Prospectus. (These will be discussed later.)

The forms must carry the signatures of the directors, except the list of persons consenting to act as directors, which must be signed by the applicant, who may be one of the promoters, or directors, or the solicitor engaged in the formation.

When these documents are lodged at the Companies' Registry they are examined by the Registrar. If they are not questioned or challenged they are provisionally accepted on the payment of the necessary duty and fees. The papers are scrutinised again after a few days, and if they are passed the Registrar issues his *Certificate of Incorporation*.

This Certificate is dated the day of its signing. It is evidence that the requirements of the Companies Act have been met and that the company is authentically registered. From that day the company assumed its legal entity. If it is a private company it may then and there commence business. If it is a public company the secretary or one of the directors must make still another declaration that (a) shares held subject to cash payment have been allotted to an amount not less than the minimum subscription, and that (b) every director has paid on the shares he has taken or contracted to take, and for which he is liable to pay cash, the amount payable on application and allotment on the shares offered for public subscription. This declaration having been made, the Registrar issues a *Trading Certificate*. (If there has been a Statement in lieu of Prospectus the declaration varies in form.) Until that Trading Certificate has been issued a public company cannot begin business: any person who contravenes this part of the Act is liable to a penalty not exceeding £50 a day. Any contract which is made before the date on which the company may legally start business is provisional and becomes binding only on that date.

The fees to be paid on the incorporation of a company are these:

With Stamp Duty on Capital at 10s. per cent., and a fee stamp rising to a maximum of £50, the total duties and fee may be a heavy sum. With a nominal capital of

£100 it is £2 10s: with a Nominal Capital of £1,000,000 it is no less than £5,050. It is often wise because of this to give a company a small nominal capital and to exercise borrowing powers (on Debentures) later, but generally a company registers a nominal capital in excess of the nominal value of the shares actually to be issued, so that any fresh capital requirement does not entail the necessity of registering an increase of capital.

In practical workaday life it is foolish, if not impracticable, to attempt the formation and registration of a company for oneself. There are skilled professional people ready to undertake the routine of the business for very moderate fees. The wise entrepreneur employs either a good registration agent or a company solicitor for the work, just as he seeks a good issuing house when he wishes to obtain his finance. It is, however, important that the controllers of a company should know what is involved both as to routine and costs.

Obviously the first thing that has to be done with a business is to obtain capital for it, which means the raising of money—finance.

With a small business the inaugurator can begin by using his own savings, by taking in a friend either as an active or a "sleeping" partner, by borrowing from Aunt Jane or Uncle John, or by pawning his life insurance policy to a bank. But money he must somehow or another obtain.

He will not need as much money as pessimists advising on his venture may think essential: he will probably need more than he in his natural optimism thinks necessary. Once the business is started he will probably find that his suppliers will give him sufficient credit to carry him on until his own payments from people he has supplied come in. In other words, his creditors actually finance him, not in money but in goods or services.

His desire to transform his business into a limited liability company will arise from one of two springs, or probably both. He will wish to keep his home secure from any financial disaster that may befall his business:

*he will envisage the day when his expansion will make more capital (i.e. finance) desirable or even vital.*

It is true that under English law such a man can bring into his business a limited partner, that is a partner whose own commitment to the fortunes of the joint enterprise is limited to the amount he puts into it; who, if it fails, will not be totally ruined, as will be the unlimited partner he has joined. But limited partnerships are not wholly understood by most people and have never been a very popular method of securing finance outside certain types of business.

The man who merely wants to limit the liability of himself, or of his family friends, in a small business will need to do no more than convert his business into a private company, limited by shares.

In ordinary circumstances such a company need have the smallest of nominal capitals—say £100—to keep fees and duties down. The amount of capital registered does not limit the amount of money that can be brought into and used by such a company. Working capital can be built up by loans to the company. But if the business is to ask for large credits from suppliers, a small nominal capital may be a hindrance. Those approached as suppliers may refer to the structure of the company and be misled as to its strength by the smallness of its nominal capital. If this is a situation likely to arise, the payment of extra fees for a more imposing capital structure may be an eventual economy.

It is only when large sums of immediate or future capital are envisaged that a public company is appropriate. A public company, as its very name implies, hopes to attract to its funds money from the public at large. Its registration is thus normally but the prelude to an invitation to the public to subscribe for its shares.

As the most common problem that arises is how to finance either a big new idea, a new process or invention, this may usefully be said: capital for such a project is never easy to obtain but when it is asked at the beginning of the venture it should be asked on the largest possible

*scale. When the showman stands before the marvellous Treasure Cavern he may well expand upon its beauties and thrills and ask for the sixpences of his potential audience, but once the Cavern is open and its contents inspected he will find difficulty in bringing in fresh sixpences unless it has passed the expectations he has aroused.* A company, particularly a new company, that issues only a small proportion of its nominal capital on the grounds that for the time being it can only usefully employ a small portion, may find that working capital is more quickly absorbed than was expected, or that profits are slower in the making. It is better, with this possibility always present, to call in more funds than may be needed, even if they have to be employed on investments not thoroughly remunerative, than to try vainly to place more shares for new working capital at an awkward stage of the progress of the business. This applies whether the company is a small private company or a large public company.

Similarly, if a small private company is formed to conduct an enterprise in its first formative years, with the expectation that sooner or later it will be transformed into a large public company, it must be remembered that before the public will subscribe to a venture already some few years old, it will demand (and the issuing houses will demand) a reasonable profit margin as a datum with a strong ratio of rising profits. Unless these can be forecast almost beyond a doubt, it is better to risk the whole matter by making a public company from the very inauguration of the business. It is better to face disappointed shareholders for two or three annual meetings than to invite premature death to the enterprise because at the moment when larger capital is needed—when the private company is ripe on its trading prospects for more working capital—the actual disclosed profits are not adequate to tempt in the public subscribers.

In passing, I may note here, probably not for the last time in this book, that a private company has no special magic when it comes to the question of inviting fresh public money by its transformation into a public com-

pany. When either a promoter or the public itself is approached for capital, several things are necessary. The percentage of profits and their percentage of increase from year to year must be adequate. The prospect of earning profits on something of the same scale upon the increased money employed must be fairly sure, or at least plausible. *The venture must not depend upon one man.*

Let me elaborate that: If Angus McTavish comes to me with a small business that he founded four years ago in Glasgow and shows that on a small capital it has made for him profits rising from 5 per cent. in the first year to even 500 per cent. in the fourth year, and that such is its hold on its customers that almost an infinity of new money can be employed in a similar profitable way, I shall, *prima facie*, in my capacity as a financier, be attracted. But if McTavish's wonderful enterprise depends upon some quality in its founder, some craftsmanship, or personal drive, or personal hold on the trades the business serves, I have to remember several things. Once Angus McTavish is transformed from the successful one-man entrepreneur into the chairman and managing director of a public company he may lose energy. He may take to drink, or racing, or women. He may lose interest and begin to put his remarkable qualities into some other use, whether it be devising another company or lowering his golf handicap or whatnot. Similarly he may die, or lose his sanity, or contract infantile paralysis, or take to politics or suffer some similar affliction. I dare not risk my own or the public's money on the variety of chances and mischances that affect that one life. And the position will be no whit different if McTavish is an ordinary unlimited business man or if he is the one man in a small private company. If, however, McTavish, with that hard Scot's sense of his, has had the wit not only to make his business into a private company but also to use that company as the training-ground for fellow directors who have acquired or are visibly acquiring his own qualities or his own hold on the trade, and who are ready to sign service agreements with the new public company,

my attitude alters. I welcome the McTavish proposition with open arms, and either supply privately a little more finance to expand the enterprise until we judge the moment ripe for flotation (i.e. for an appeal to the public for more finance) or I go at once to flotation.

A private company may even have a disadvantage compared with a one-man business when the need for new and wider finance arises. A private company by law need not have more than two members and may not have more than fifty members. It is thus an ideal organisation either for two working partners in complete accord, or for a one-man business where a relative or friend (or group of relatives or friends) will come in to satisfy the need for the minimum membership or to provide a little more capital than the original man commands by himself. But these early extra members may turn stupid at a stage when the real head of the business desires to transform the private company into a public company. They may want more for their shares than is convenient or just, and may be prepared to exercise their undoubted "nuisance value" in the business. They may insist that when the private company sells itself to the new public company they are to be provided with this or that job or privilege.

In deciding what manner of company to consider these potentialities must be well weighed. The problems are virtually the same whether I am considering the formation of a business to launch upon an avid and eager buying public "Brooks' Beauty-making Beans for Brunettes," a company to expand a small grocery business into a chain of multiple stores, or to found or invigorate a local newspaper, or to trade with the Antipodes, or to market a new film colour process. The small maker of push-bicycles who sees himself another Ford or the new master-maker of light aeroplanes; the advertisements clerk who sees himself another Northcliffe; the inland barber who sees himself the potentially richest of beauty-parlour owners—all face the same troubles and "snags" at the moment when the project is either only just con-

ceived or in its birth throes. All must remember that, in whatever way the early capital is found, the formation of a private company to limit liability must be weighed against the potential hindrance to new finance which a private company may some day mean; all must remember that at times there is success in a foolhardy courage in "going for the big thing" rather than in a wise prudence which only aspires to grow by stages *to* that "big thing."

This is only another way of saying that money is very often easier to get in mammoth quantities than in small packets, that the public is often more ready to buy an unknown but infinitely promising future than a known past leading to a half-guessed and thus limited future. In considering the early financing of a company it is the effect of these things, and factors like them, upon future finance that must govern all decisions.

## CHAPTER III

### HOW FINANCE IS OBTAINED: PRELIMINARIES

AT this point I would lay down an axiom. The secret (and problem) of successful company finance is to obtain capital at the cheapest possible rate with the minimum prejudice to future needs and future action.

Recalling the Irishman who said that repartee was only an insult with its dress clothes on, I admit that my axiom, like any other, is only a truism in formal dress, but successful business is governed by truisms and common-places.

There follows a second axiom. No company finance can be successful unless it is governed by a financial plan of long scope.

Spasmodic finance—i.e. the haphazard selection of arbitrary sums as likely to fill improperly estimated needs—may, by a series of “flukes” and the grace of Providence, be occasionally successful, but as a rule it is fatal. No business man can afford to consider himself or his affairs as outside the rule.

Except in the case of those businesses which in their first stages are really the children of circumstances, the financial plan should be prepared and brooded over before the first penny of money is raised.

What is meant by a financial plan I will discuss in Chapter VI. Here I merely emphasise the need for its existence and its importance.

The existence of a financial plan implies the co-existence of other plans. There must be a management plan and a sales plan, and from these parents the finance plan should spring.

The alternative method is to envisage the amount of finance that is either needed or possible, and from that to derive the management and sales plans. This is like the political "public-works" heresy, which would raise from the community vast sums of money and then look round for ways of spending them.

In the initial appeal for finance the applicant MUST first know not what he wishes to do with the *money* when he has raised it, but with the *business* for which it is to be raised.

That wish will have to be modified by half a dozen considerations, but it must first be formed in the fullest-blooded integrity, as if no limitations were possible. To take an analogy—always a dangerous proceeding, but always useful—an inventor does not say "I see the possibility of so much power from such and such a source, therefore I will invent a machine to use it." He rather says, "I conceive this invention which will do certain things for mankind, to my personal profit and glory: I will perfect it, and then find the requisite sources of power."

In the last chapter I mentioned the simplest means of raising finance—through a man's friends or relatives. But very often friends and relatives have no finance to provide, or they exemplify the saying of Holy Writ that a prophet is not without honour save in his own country. What means, then, can be taken to find private finance?

The easiest way is to advertise the need. Anyone who has a new process, a new article, or a small business to finance will find that an advertisement, carefully worded, and inserted in the right organs of publication will draw an adequate response. Obviously no such advertisement should be unguarded in what it tells of the project, but it must contain enough information to assure any interested person that the project is real and not bogus. Once framed the medium must be chosen with equal care. The financial papers of repute, the heavier daily papers, and the legal journals, are the most appropriate of the available media.

Of the answers that come, it is safe to say that almost 90 per cent. will be useless, and of that 90 per cent. 90 per cent. will be dangerous. The world is full of sharks, titled and untitled, ready to raise money for anything under the sun—for a commission. The worst of them demand a sum in advance for enquiry expenses. All these parasites should be avoided. Nothing is easier than to put their letters to some useful domestic purpose.<sup>1</sup>

Of the 10 per cent. remaining, most will be found to be useless from some good reason, either because the financier does not fancy the project, or wants a smaller or bigger use for his money, or desires too much control, or has regretted his initial response.

Let no one think that the raising of money by advertising for it is anything but a heart-breaking business. There is only one more disappointing way, that is by trying to finance a business already doing well by soliciting the capital support of its suppliers or customers. There is no house of any size which does not receive scores of requests for finance for small businesses with which it has dealings. If it supplied finance for all it would have no working capital for itself.

But the fact remains that advertising is the only way once the immediate circle of the entrepreneur has been exhausted, that immediate circle, of course, including local bank managers and solicitors, who often have clients who are actively looking for investments in private ventures in their infancy stages.

If advertisement proves of no value, small finance may often be raised by taking the project to an issuing house with the simple suggestion that an issue may be made. The harmless subterfuge here is that no issue is anticipated, but a hope is cherished that the issuing house may itself, or through its attachés, nurse the infant venture with privately supplied capital until an issue is possible.

Here again, let there be no rosy illusion. The result is extremely unlikely to be successful. There is no

<sup>1</sup> Such as the making of spills.

harder task in the world than finding finance for small enterprises.

It is true that within the past two years two special corporations have arisen whose avowed purpose is to find finance for the small man, but it is equally true that they do not exist to take undue risks. Their business is to finance on adequate security. They differ from a joint-stock bank in one regard only, that they will tie their money up longer. A bank does not exist to supply standing capital, but to supply temporary capital. It must know the difference between a bill of exchange and a mortgage. The new companies which offer finance to the small man will provide a mortgage on plant and the like, where a bank will not. That is the difference. Anyone who thinks that these companies are ready to back his future on no material security deceives himself. A moment's thought will show that a company which did that would be only a respectable kind of gambling society.

One thing such an organisation as Credit for Industry Ltd. will do is to finance the purchase of plant by bills of exchange. It will not hand out finance in lump sums, but it will aid a man to pay his bills for plant and the like on a long-term instalment system. For a business able to make a good profit-ratio this means that heavy initial capital expenditures can be financed out of revenue, at a cost.

Private capital, with reasonable luck, can thus be raised for a share in the business or on fixed interest : it may be obtained from a bank on reasonable security for short-term use: it can be obtained from organisations such as Credit for Industry Ltd., or the Charterhouse Industrial Trust, Ltd., on adequate security for longer term use.

But finance so obtained, if the project flourishes, is only the preliminary to the true method of raising large finance, which is by public subscription.

Before examining the method of so raising finance it is as well to study one or two preliminary needs.

Some of these needs are elementary, as for example the need to be aware of the various ways in which a

company can invite public money. In a book of this kind there need be no apology for rehearsing the elements, though it involves retracing some of the ground already covered.

A company may invite the public either to take a share in its fortunes or to lend money at an agreed rate of interest. Here we have the primary difference between shares (or stock) and debentures (or debenture stock).

But the shares to which the public is invited to subscribe may be of two kinds. One kind limits the return to the subscriber and gives him some other advantage for his limitation. The other kind leaves the subscriber to have his full proportion of the "share-out" each period after prior charges have been met. This is the difference between preference shares and ordinary shares.

These broad categories have been divided, from many motives, into various subdivisions, of which there now follows a catalogue of the most familiar:

**DEBENTURES.** This is a colloquial name for debenture bonds or debenture stock. A debenture bond is a security given by a joint-stock company for money raised in addition to the capital subscribed by the public. The form of the security given is usually a charge or mortgage issued by the company. It bears a fixed rate of interest and may be redeemable during the existence of the company. Debentures are of two main classes—those which give the holder a specific security upon the property or assets of the company and those which give no such particularised security. The first class are known as secured debentures and the second class as unsecured debentures. Debentures may be (*a*) payable to a registered holder, (*b*) payable to bearer, (*c*) payable to a registered holder but with interest coupons payable to bearer or (*d*) payable to bearer but with power for the bearer to have them placed on the register and at any time to have them withdrawn therefrom.

**PREFERENCE SHARES** (or stock). Shares (or stock) entit-

ling the owner to preferential rights over other shareholders as regards dividends and/or capital. These rights may be cumulative or non-cumulative. If they are cumulative the holder is entitled to an agreed rate per cent. each year out of profits earned and if in any year or successive years this rate is not paid to him, the deficiency or accumulated deficiency is payable out of the profits of future years before ordinary shareholders have a right to claim dividends. If the rate is non-cumulative the holder has a right to a fixed rate per cent. in any given year, but if the profits of that year do not permit payment he has no right to call upon future profits. (With voting power on such shares we shall deal later.) After receiving their fixed rate such shares may further participate in profits or not, as agreed by the articles.

**ORDINARY SHARES** (or stock). These are straightforward shares in the prosperity of the business which, however, cannot claim a share of the profits until prior charges have been met. Prior charges include such commitments as the agreed rate of interest on debentures, or on preference shares, if any.

**PREFERRED ORDINARIES.** Ordinary shares with a limited preferential right to distribution before ordinary or deferred ordinary shares.

**DEFERRED ORDINARIES.** Ordinary shares which—as the name implies—rank last for distribution of dividends. These, like management shares, are often created to preserve to a small section of the company the right to a major proportion of its profits. After the payment of, say, 5 per cent. on the ordinaries the deferreds and ordinaries may share equally in any further distributable profits. This half-share may be a large sum of money and on a small issue of deferreds may make a very high percentage. Or, similarly, if a company has to meet the interest on a block of debentures and on a block of preference shares, it may decide to divide any balance by paying a fixed amount on the preferred ordinaries and then

splitting whatever is left equally between the preferred and deferred. It may so happen, because the nominal amount of the deferreds is small, that this half-share in the residuum will represent a very large rate per cent. One warehousing company habitually pays its deferred holders over 200 per cent.

At first blush the task of deciding what kind of capital to issue (or invite) would seem simple. It is rarely so. Many things have to be taken into consideration, not least the mood of the markets. There are times when the public will subscribe fixed interest capital much more readily than ordinary capital, there are times when ordinary capital is more readily supplied than fixed interest capital.<sup>1</sup>

Far more important than market mood, important as that is, is the question of control. Every share carries a right to vote, and votes are allotted to the various categories scientifically, and not at haphazard. Every debenture holder is a legal creditor who can when his interest is in default fling the enterprise into liquidation. If the founders could so arrange their capital that they retained a majority of votes, either by holding a majority of all votes or by making certain votes contingent upon some unlikely happening, and could persuade the public to put up its money merely in the fond hope of dividends, all would be well. Such a gratifying arrangement is rarely possible in real life. The public not only wants to buy a share in the profits of the business, it wants also to buy a voice—no matter how still and small—in the control. It wants to come to the Annual Meeting and air its grievances, if necessary.

With a business of infinite potential profit it is obviously wiser to limit the public share of profits to an agreed fixed interest, and, if possible, to make that share redeemable. This would mean the retention by the founders of the

<sup>1</sup> An analysis for the reasons of these moods will be found in the author's *Profits From Short Term Investment*, second edition.

ordinary capital. But the public may not be prepared to take preference capital unless some share in profits goes with it, unless, that is to say, the preference share is a participating preference share or shares are allotted in the ratio of so many ordinaries to so many preference. (A participating preference might carry, say, 6 per cent. with a right to a further disbursement whenever the ordinaries have had more than 10 per cent.) Again, a future appeal for capital might be prejudiced if a company had too much of a debenture debt. As I insisted in my second axiom, present capital must not be allowed to prejudice future capital, either as to division of profit or guidance of the company.

In selecting the category of shares that are to be offered the golden rule is to assume that the enterprise will last eternity out, and during the passage of time will inevitably suffer many vicissitudes. One example of a failure to make this assumption obtruded itself after the crash of the Kylsant shipping group. There a certain company had a block of preference capital carrying ten votes per share to every one vote per share of the ordinary, but unable to use those votes until preference dividends dropped into arrear. Preference dividends did drop into arrear after the great slump, and the holders of those shares obtained control. Their first thought, very naturally, was to make their temporary control permanent, by voting a change in the structure of the company. This attempt was challenged in the courts as being a misuse of powers, but had it not been made there was still the perfect method of retaining control, by wilfully keeping preference dividends six months in arrear and thus keeping alive the voting power. One of time's revenges is that rash or derisory promises nearly always come up for fulfilment. A company that tempts new capital in at a pleasant rate by adding the bribe of a contingent power which it thinks will never be exercised, tempts fortune.

How the capital of a company should be arranged is entirely a matter for the individual company. Generalisation is impossible with any regard for safety.

But it is a safe rule that (if circumstances permit) fixed interest capital and debt (that is preference shares and debentures) should be redeemable. It is also a safe rule that not only should a company be always conceived as formed to last for eternity, but that it should be conceived as being potentially the purchase of new owners. Where control can be arranged in such a way that a small group of owners of capital virtually own the company, and the larger group merely owns rights in the company (rights to dividends and distribution of assets if the company winds up) the position of the enterprise is more manageable than if the control is vested in a mass of scattered shareholders.

Nobody need have any moral scruples about striving to arrange such a consummation. When the public is invited to provide capital, it knows upon what terms the capital subscribed will be received. Many an enterprise which continues to flourish under the control of a larger enterprise might fail quickly under its own management. If the moment of transition arrives and the transition is baulked by a scattered mass of shareholders who do not understand the economics of the business, so much the worse for all. In spite of lurid tales of the rapacity of holding and parent companies, no man buys an enterprise to ruin it, although many enterprises are bought only to be wound up.

The preliminaries of raising capital by a public issue thus include:

- (1) A finance plan, backed by a management and sales plan, upon which the true sum to be raised will be based. This sum may be changed by circumstances later to be explained.
- (2) A careful estimate of how cheaply the capital can be raised in view of the need to protect future capital raising and in view of the prevailing mood of the market.
- (3) A careful decision upon the types of capital to be invited, in view of the future (and enduring) control

of the enterprise, modified by the view of what the public regard as a fair proportionment of voting power; the aim being a proportionment of voting power which will not rebuff the public but which will leave future control of the company free from embarrassment.

On these preliminary considerations can be safely based such decisions as the amount of capital required, the amount of temporary debt-capital desirable, and the potential future need of further capital.

Of the amount of capital required by the company we may postpone discussion until we consider the finance plan. If we assume that it is wisely fixed, the second of our three preliminaries—the cheapness of capital—becomes the paramount thought.

It must not be imagined that offering the public a share in the equity of a business (that is, offering them ordinary shares) is necessarily a cheap means of raising capital. True, if the business does not earn much, it does not pay much. But if the business is from the first prosperous, ordinary capital is dearly bought. To pay, say,  $12\frac{1}{2}$  per cent. on a block of ordinary shares which represent capital that could have been raised on an 8 per cent. Preference share or a 6 per cent. debenture is obviously wasteful from the viewpoint of the promoters of the enterprise, if those promoters are to continue in control and possession. On the other hand, as has been said earlier, the mood of the market may make a fixed interest share hard to sell. In any event, many companies must issue to the public both ordinary and preference shares, and the public nowadays is trained to look closely at the "gearing"<sup>1</sup> of a company. The "gearing" represents the ratio of fixed-interest capital to ordinary capital.

The "gearing" of companies varies widely. The amount of ordinary capital to each £1 of fixed-interest

<sup>1</sup> A useful term invented by Mr. Hargreaves Parkinson, of the *Economist*, and now in universal use.

capital, for example, in the L.M.S. Railway Company is 0·3 to 1, whereas in the British Match Corporation it is 11·8 to 1. The proportion of ordinary to fixed-interest capital is no clue to the soundness of a company, but it is a clue to the soundness of an investment in the ordinaries of that company. Earnings on ordinary shares in a high-geared company will fluctuate much more than those in a low-geared company—for the simple reason that as total profits fall the fixed amount on the large mass of fixed-interest shares represents an ever-increasing proportion, which means that the small proportion left for the ordinaries reaches the holder as a diminishing percentage return on his money. The higher the gearing, then, the more unreliable the ordinary share from the viewpoint of earnings. When total earnings are rising steeply, the high-geared share is the better; when total earnings are falling the position is reversed, for then the low-geared share is the better. When earnings are on a continuing level, with very little fluctuation, the low-geared shares are, again, the better. These things investors to-day have been taught, through their advisers, to watch. They affect the reception of a public issue.

Having determined the amount of capital to be raised, the kinds of shares to be offered, and the control-structure of the enterprise, the promoters must next seek an issuing house to conduct the business of inviting the public's money and of gathering it in.

## CHAPTER IV

### HOW FINANCE IS OBTAINED: A PUBLIC ISSUE

THE raising of finance by the offer of shares to the public is achieved in several ways.

The company can make the direct offer to the public, i.e. it can invite the public to subscribe its capital.

The company can allot its securities to a third party, and that third party can then offer them for sale to the public, the original allotment having been for that purpose.<sup>1</sup>

A third party may offer the shares to the public for purchase without the shares having been allotted by the company with a view to their being so offered.

The company may have the shares *introduced* on to the Stock Exchange having previously *placed* them privately with one or more Stock Exchange firms by whom application is made to the committee for permission to deal in them.

Between the second and third of these methods there is little more than a technical, legal difference. The

<sup>1</sup> Under the Companies Act 1929 it is evidence (unless the contrary is proved) that the shares or debentures were allotted with a view to their resale to the public if it is shown:

- (1) That an offer of the shares or debentures or any of them for sale to the public was made within six months after the allotment or agreement to allot the shares was made or
- (2) That at the date when the offer was made the whole of the consideration to be received by the company in respect of the shares or debentures had not been so received by the company.

Even if the offer is made more than six months after the date of allotment and/or the shares and debentures have been fully paid at the date when offered to the public, the Act regards the transaction in the same light if in fact the securities were allotted with a view to their being offered to the public.

fourth method is growing in popularity, but is beginning to be suspect as implying too heavy a middleman's profit. It is the first method, the direct invitation to the public to subscribe capital, which is the normal way of raising capital. The machinery for handling such an invitation applies with very little adaptation to offers for sale.

In theory there is no reason why the promoters of an enterprise should not bring the issue to birth themselves; in practice professional aid is so useful as to be virtually a necessity.

It may simplify the understanding of the procedure if we assume that a promising proposition has been brought to an issuing house which undertakes to float it.

A prospectus must be drawn up. That document must comply with various legal requirements.<sup>1</sup> It must be dated. It must be signed by every person who is named therein as a director or proposed director of the company, or by his agent authorised in writing. That signed copy must be delivered to the Registrar of Companies for registration on or before the date of its publication. The prospectus must state on the face of it that a signed copy has been so delivered. It must set out the contents of the Memorandum of Association, with the names, descriptions and addresses of the signatories and the number of shares subscribed for by them respectively. It must state the number of shares, if any, fixed by the articles as the qualification of a director, and any provision in the articles as to the remuneration of the directors, with their names, descriptions and addresses. It must show the amount or estimated amount of preliminary expenses . . . and so on . . . through a long list of requirements which will be found in the Act itself, duly set out in the Fourth Schedule, and discussed in Sections 34, 35, 36, 37 and 38, reprinted in this volume as an appendix.

Having drawn up a draft prospectus the raisers of capital have much to do before they can issue it to the public. They must find a bank willing to act for them, to issue prospectuses and accept applications for shares

<sup>1</sup> See Appendix I.

with the necessary "application money." They must find at least one firm of brokers who will act as brokers to the issue. They must find a firm of accountants willing to act as auditors to the company, subject to the approval of a general meeting. The legal obligations surrounding an appeal for capital are so many and so onerous that it is well to have a firm of solicitors who will act as solicitors to the issue, quite apart from any firm which acts as solicitors to the company.

Of all these functionaries it is difficult to say which is the more important. Although a bank by acting does not in any way endorse the soundness of the company making the appeal for capital, none the less the name of a good bank does influence public opinion, and a joint-stock bank with many branches and many customers does help in attracting the attention of small investors. The good name of the accountants is likewise construed as a guarantee that the affairs of the company are to be open to the most thorough and searching investigation.

But from a severely practical point of view, the standing of the brokers is, perhaps, the most vital. It is to the brokers that the task of making a market in the shares will fall. When the public subscribes money to a company it desires three things—the hope of reasonable return, or the chance of capital appreciation, safety, and liquidity. By liquidity is meant the certainty that if the share holding has at any time to be relinquished the shares will find a ready market. Actually the men who make markets in shares are not stock-brokers but stock-jobbers (or dealers), but a broker to an issue generally has friendly relations with certain jobbers with whom he works in concert. Making a market means, in essence, the readiness to take or sell shares as they are offered. If there is no natural flow of shares, it may become necessary to allot shares to certain interests in order that such a flow may be created or stimulated. A share which is in the hands of indifferent brokers or jobbers may suffer all its life from a sluggish market. It must not be forgotten that the broker will have a list of clients whom he can interest in

an issue which he has found attractive enough to put his own name to.

However intrinsically an issue of capital may be, there are always factors at work which may prevent a full response from the public. It would be fatal to a company trying to raise finance if its appeal for funds left it inadequately supplied. To prevent such a catastrophe, the issue will be "underwritten." This is achieved in this way: the makers of the issue approach the firm of stock-brokers whom they desire to act for them. If the firm of stock-brokers is satisfied that the issue is sound they will make a contract with the promoters whereby they (the brokers) undertake to subscribe for any portion of the shares not taken by the public, in return for which they receive a commission, usually in the form of a percentage on the whole issue. The brokers, of course, do not wish to carry the whole of this risk themselves. They have clients and friends who will participate with them. With these clients and friends the brokers will enter into what are known as sub-underwriting contracts. One of the most important things for the appealers for capital is that these sub-underwriters should be sound men and not men of straw. Weak underwriting is often fatal to a company.<sup>1</sup> The brokers who do the main underwriting pay a commission to the sub-underwriters which is usually fixed in proportion to the amount of risk each takes. The brokers themselves take what is known as an overriding commission as remuneration for arranging this sub-underwriting, i.e. they have their own commission for the risk they undertake and an extra commission for their services in arranging for the availability of other risk-takers. It is customary, when underwriting is being undertaken, for underwriters and sub-underwriters to be given the opportunity of taking certain shares firm. To "take firm" means to subscribe exactly as members of the public will subscribe, and not merely to promise to take those shares which the public has not wanted. It

<sup>1</sup> See the author's *Theory and Practice of Finance*, where this is discussed in detail.

is needless to emphasise that where brokers take shares firm those shares are regarded highly. The granting of the right to take shares firm is not as simple a matter as it may seem. If the issue is over-subscribed by the public the share given to the underwriters must not be allowed to be an unfair proportion. If the issue is under-subscribed, the broker (or other underwriter) will expect the number he has promised to take firm to be regarded as relieving his full responsibility.

In view of all these complications, the money paid to a finance house or issuing house for its services is money well spent. Even the mechanical routine of the business is complicated.<sup>1</sup>

It must be remembered that any applicant for shares has the right to withdraw his application until the moment of allotment. Even after the lists are closed, he may still withdraw his application. The receipt of applications, the despatch of letters of allotment (or of regret that allotment cannot be made), the scaling into proportion of applications where the issue is over-subscribed, the gathering of application money, the payment of cheques for brokerage—all these, plus the need to submit forms to the Stock Exchange “Share and Loan Department” for approval and the making of application for permission to deal, constitute a very specialised business indeed.

It is very rarely that a company asking the public for money requires all the money at once. The usual procedure is to require a small sum when application for shares is made. This is the application money mentioned above. After that a further sum will be asked when the shares are allotted. The remainder will be “called” as convenient. Thus on a share of £1 nominal value, 2s. 6d. may be asked on application, 5s. on allotment, 2s. 6d. one month after allotment and the final 2s. 6d. three months after that again.

Those who have to handle the company's finance must always remember that money can often be an embarrass-

<sup>1</sup> Its exposition fills a valuable small book, *The Routine of a Public Issue*, by Oswald M. Brown.

ment. The assumption is that the money raised is to be used for some profitable purpose. If it is obtained before it can be so used, it must be put out at the best safest rate obtainable, which may be very little. To use an old idiom, it eats its head off. The ideal is to obtain money only as wanted.

This is one of the considerations which will govern the selection of dates at which subscribers' money is called up after shares have been allotted.

When money is obtained by means of a public issue the total invited must exceed the amount required for genuine business purposes. A certain proportion of the sum raised will have to be paid out in connection with the issue itself. But dividends will have to be earned on the nominal total, including that sum which has been paid out in such preliminary expenses. In stock-market idiom, the amount which the money costs to raise will be so much "water" in the capital. It will demand earnings without making any. To simplify the matter—if a company has a nominal capital of £100,000 which cost £10,000 to raise, and makes £10,000 in its first year, it shows 10 per cent. gross earnings, but since the £10,000 has been made on only £90,000 it has made over 11 per cent. on its working capital.

The converse of this situation is seen when a well-established and prosperous company is able to issue shares at a premium, i.e. to ask more for a share than its nominal value. If the public is willing to pay £2 for a share only nominally worth £1, and 100,000 of these shares are issued at that price, the company then has £100,000 working for it, i.e. earning dividends, on which dividends are not declared. If on the £200,000 raised the company makes £20,000 it is able to declare (assuming that every penny earned is so distributed) not 10 per cent. but 20 per cent.

If preliminary expenses are not closely watched they have a tendency to mount high, and if they mount too high they prejudice the chances of the new shares receiving permission to deal on the Stock Exchange. Not only

have the various functionaries—the banker, the broker, the underwriters and sub-underwriters, the lawyers, the issuing-house clerks, and their like, to be remunerated, but relatively large sums of money have to be spent on making known the issue to the public. The issue has to be advertised in at least two London daily papers, and it is desirable that it be advertised in more. Advertising space for financial announcements, particularly prospectuses, is not cheap. The placing of such advertisements is not wholly a matter of letting the public know that its money is invited. There is a very sound practice in financial journalism of commenting upon prospectuses advertised in the columns of newspapers. The mere fact of paying a paper to admit an announcement into its columns does not buy the goodwill of the editorial commentators. The comment may be damning if the prospectus deserves damning. But at least the presence of an advertisement tends to ensure that some notice will be taken of the offer of shares by the professional commentators.<sup>1</sup>

It will be obvious that the ratio of preliminary expenses decreases with the size of the issue. Some charges rise in proportion—these are legal charges generally—but others do not. The overhead costs of handling the issue will not be very much affected by its size, and publicity charges may be as low for an issue of £2,000,000 as for an issue of £50,000.

However this may be, the point which concerns us at this moment is that the people who invite finance for their enterprise by means of a public issue should bear in mind that the cost of the issue must be added to the minimum amount needed for working capital when the money has been subscribed and all charges paid upon the process of raising it.

Emphasis has already been laid on the importance of

<sup>1</sup> Newspaper practice differs. When Anglo-Foreign Newspapers, Ltd., offered its prospectus as an advertisement, certain papers, like the *Daily Mail*, refused to admit the advertisement. Others, like the *Financial News*, accepted the advertisement, but condemned the issue.

obtaining "permission to deal" from the Stock Exchange. The subscriber of new capital, it has been pointed out, desires some assurance that if he supplies his money by taking shares, he can, when he wants money again, find a ready market for those shares. There is a secondary aspect of "permission to deal" which is equally important. As was said in the opening chapters, when finance is raised it should always be with the thought in mind that more will some day be needed. If a company's shares are quoted on the Stock Exchange, they will reflect the prosperity (or supposed prosperity) of the company. When the company is doing well, or is believed to be doing well, the value of its shares will rise. It is when a company is doing well that it is most likely to be able to use new capital. If its existing shares stand high, new shares offered will receive a better welcome than would otherwise be the case, which means that future capital can be raised more easily and more cheaply. How permission to deal is obtained can best be ascertained from a perusal of the Rules of the Stock Exchange—an extract from which will be found in Appendix II.

## CHAPTER V

### WHAT THE BANKS WILL DO

THERE is so much misapprehension and false optimism about what a bank will—or, indeed, can—do for its customers that a short chapter on this topic may be useful to less sophisticated readers, however familiar the ground may be to more experienced men of business.

A wise old banker in the nineteenth century said that the whole art of banking lies in knowing the difference between a bill of sale and a mortgage. In other words, no customer can hope to obtain finance from his bank if the security he proposes to deposit against the loan is not reasonably liquid.

The type of security acceptable to a bank varies enormously. It varies, as a rule, according to the nature and location of the business. Stock-market securities, documents of title to goods in transit, advances against produce, advances against life policies are all common. Advances against personal guarantee are not so common. Advances against deeds of property are common enough in agricultural districts and are to be met with in general business on special occasions, but land is not normally a banking security and real property is acceptable only from good borrowers for short periods, as, for example, when a mortgage is in process of completion. If money is wanted on such security, the proper lender is not the bank but a solicitor or a building society who can put up mortgage money.

The bank which lends on stock-market securities naturally ensures that the amount lent is below the marketable value of the securities pledged. This means that a

market fall may cause the bank to contract its credit to the borrower.

When such securities are tendered the customer may expect the bank to make most careful enquiries not only as to the status of the borrower but also as to his intention. It will wish to know how the money is to be applied, whether as liquid capital for the business or for the purchase of fixed assets, such as plant, buildings, etc. If the customer's intention is to apply the money to some long-term use, most bankers will recommend that it be raised by some other means, either by mortgage or by the issue of new capital.

The applicant will be required to provide for the bank's inspection a balance sheet or statement of affairs. A form is used which shows liabilities on acceptances, guarantees, open account, to the bank and others, and shows assets in book debts, stock in trade, property and life values, both nominal and surrender values. With a limited liability company the normal balance sheet may suffice the bank's needs, plus oral explanations and expansions from the responsible officers of the company.

The banker as lender views the assets of a potential borrower with very different eyes from those of a shareholder. His division of liquid and semi-liquid and fixed assets will be subject to special classifications. One of the first lessons of a practical banker in this regard, for example, is to distinguish sharply between different kinds of building, looking with more favourable eye on warehousing buildings than upon factories, for the former can be adapted to new uses without trouble, the latter may be of little use to any owner outside the original business.

Similarly on the liabilities side, the bank's inspection will be close and special.

The "permanent" liabilities may include amounts lent to the firm by relatives or employees . . . although the banker may be satisfied that the employees or relatives of late partners have agreed not to withdraw their money without giving long notice; he is also well aware that, in the event of the firm being in difficulties, the relatives and ex-partners frequently have opportunities of learning

in advance of the trouble, and, human nature being what it is, will not hesitate to use that knowledge to advantage. They will suddenly discover that they want to buy their houses, or set their sons up in business, and so forth. . . .—F. E. Stecl: *The Banker as Lender.*

It is not infrequent for the bank to demand, in addition to a statement of affairs or a balance sheet, the production of the trading account and the profit and loss account.

With small businesses there will be an inevitable scrutiny of the amounts taken out of it by its partners or executives. Under the British system of banking the bank as lender does not become a partner in the business, but it has a lender's right to know whether or not the borrowing business is "top-heavy" before it adventures the money of its other customers.

A banker has, of course, a personal right of action against his customer in respect to debt, but banks do not want to fight actions if they can avoid them. It is this which makes a bank desire, where possible, what is known as "collateral security," that is some security which runs side by side with the right to take personal action for recovery of debt. It is as such collateral security that share certificates, bearer bonds, title deeds, insurance policies are deposited. In considering such security the banker will be impressed by several qualities. He will prefer something with a simple title, which can be easily transferred, which can be readily sold, which has a fairly steady value.

As a general rule, bankers do not want security which carries with it potential liability. Shares with calls or leasehold property (which may involve repairs or restoration) are not desired.

With stock-market securities the banks naturally prefer fully negotiable securities to inscribed or registered stock, with the reservation that gilt-edged securities are preferable to others.

From the viewpoint of the banker the customer must always seem unduly optimistic about loans, and from the viewpoint of the customer the banker too often seems

untrusting and hard. Actually, the banker is handling other people's money and cannot be other than hard in his approach to potential borrowers. But the banker is anxious to lend, for by lending he lives. The customer would save himself much heart burning and the banker much anxiety about giving unnecessary offence if the customer would remember what are and what are not the functions of the bank. Broadly speaking, the finance which the banks exist to provide is temporary finance. For long-term finance the company should go to the public, to private mortgagees, to building societies or to those finance companies which to-day specialise in financing plant and structures.

## CHAPTER VI

### PLANNING FINANCE

ONE of the soundest remarks ever made about business was that of Professor Hoagland, of the Ohio State University: "Perhaps the most prolific source of failures of business promotions is a defective financial plan." Bad production management and bad sales management have slain their thousands, but faulty finance has slain its tens of thousands. The financial plan of a business should begin at the birth of the business. It may grow with the business in ambition, but it should not change in kind.

The duty of the finance director is twofold, to raise finance in adequate amounts as cheaply as is compatible with protecting the interests (i.e. control, etc.) of the enterprise at any given time in its history and to see that finance when raised, or earned, is profitably used and not wastefully applied or wastefully conserved.

Every business has before it three prime needs. They are (1) the need at certain periods to command ample liquid funds, (2) the need at other times to conserve funds and (3) the need at still other times to be able to raise emergency funds for particular and unforeseen contingencies.

No generalisation is really possible about financial planning. One company must of its very nature differ from another. The company that must have large standing assets, in plant and building and stocks and work in progress, can obviously command fixed-interest capital, in the shape of debentures, that is not possible to a company whose standing assets are few. The nature of those assets will also govern the command of such capital. It is not even possible to lay down a rule as to what propor-

tion of assets can be used as security for debt-capital. It is easy for the financial purist to say that no company should have in pawn more than roughly 33½ per cent of its fixed assets, but the man of business will see occasions when a much higher percentage can be used profitably and safely as security for profit-earning working capital. What can be laid down is a kind of ideal plan to which a company can hope to work. (Even here, ideals will differ according to temperament.)

Such an ideal, to the present writer's mind, would give a plan very much on these lines. Debenture debt should not be more than half the value of fixed assets. Other fixed interest stock (or shares) should not in turn exceed more than the remaining quantity of fixed assets except by the value of current assets. Ordinary stock (or shares) should not be nominally higher than the total asset value less the amount of prior charges in the shape of trading debts, fixed interest capital and debentures.

Expressed in such technical jargon, the ideal immediately prompts the question—what *are* fixed assets and current assets, and what value is to be placed upon them?

All assets have three values. There is the value as a going concern, there is the value at break up of the business, and there is earning-power value. The difference between value as a going concern and value on earning power may seem slight, but in practice it is often not slight. Any finance plan must concern itself with the asset value on an earning-power basis.

Assets, generally speaking, comprise the property available to pay the debts of a company—the stock-in-trade, buildings, machinery, tools, book-debts, and cash. They can be divided into tangible assets—those which are readily realisable—and intangible assets—those which are not actually fictitious but which cannot easily be converted to a cash value, such as goodwill. The book-keepers have yet another category, that of fictitious assets. Fictitious assets are such entries in the balance sheet as preliminary expenses or the cost of raising money on

debentures. These items are regarded as too heavy to charge against the profits of the year in which they were incurred, and are therefore written off the books over a period of years. They appear on the assets side of the balance sheet, but they are unreal. The value of assets differs. Some may be wasting assets; others may be fluctuating assets, i.e. marketable securities the quotation for which differs from day to day on the stock market. For general purposes, and for their consideration when a finance plan is being considered, assets may be categorised thus:—

- (1) Fixed Assets. Freehold land, buildings, house property, plant, machinery, etc.
- (2) Intangible Assets. Goodwill, patents, trade marks, designs, copyrights, etc.
- (3) Floating, or Current, Assets. Book-debts, stock-in-trade, stores, raw material, bills receivable, etc.
- (4) Liquid Assets. Assets which are readily convertible for the discharge of current liabilities—cash at bank, cash in hand, etc.

It should be noted that the same asset may be fixed or floating, according to the nature of the business. A machine would be a floating asset to a dealer in machinery, but a fixed asset to a manufacturer using it in his own trade.

It will be obvious that when a business is flourishing the natural value to be placed on its assets will be the earning-power value. When a business is sick unto death, the value at sale grows in importance.

Before an enterprise can say with reasonable safety what money it will raise on the security of its assets it must endeavour to estimate what its earnings will be. When it loads itself with fixed charges (whether on Preference shares or on Debentures) those charges bear a ratio to earnings. *They should not exceed half the sum of conservatively estimated earnings.* It must be borne in mind, always, that failure to pay debenture interest may end the life of the company; failure to pay preference dividend

will not ruin the company, but it will cripple it, hurt its prestige, and make the future raising of finance both dearer and more difficult.

In the case of a new venture, or of an old venture becoming a public company, whose trade is such that earnings are hard to forecast with even approximate accuracy, the use of ordinary share capital may be wiser, even though in the long run, for considerations stated earlier, they may be the dearer way of raising finance. In businesses where profits cannot be regularised, where earnings are not only uncertain but fluctuate violently—let us say, to adapt the old joke, a company dealing in suspension bridges—ordinary shares are indubitably the best form, until dividend reserves have been adequately built.<sup>1</sup>

At this point a summing up may be useful. The finance plan has to:

- (1) Take account of the amount of money which can be profitably used.
- (2) Ensure that the money raised is raised at the cheapest rate compatible with (3).
- (3) Ensure that the control of the company is properly guarded.
- (4) Ensure that interest payments on money raised do not embarrass the working of the company at payment periods.
- (5) Ensure that debenture interest has not (*i*) pledged the assets too deeply and (*ii*) thrown the company into recurring jeopardy as interest payments approach, since debenture holders are creditors, and may throw the company into liquidation.

Since these things, as we have seen, can only be approached on a basis of earnings, how are earnings to be estimated?

<sup>1</sup> Reserves are discussed later in Chapter IX.

## CHAPTER VII

### ESTIMATING EARNINGS

IN estimating earnings the first thing to bear in mind is that the capital of the company on which money has theoretically to be earned is not the amount of capital available for earning power.

The owners of capital in a business supply finance which has to be profitably used, but that finance is reinforced from several other sources.

Suppliers of goods or raw materials who give credit are suppliers of what we may call "negative capital." This will be realised if credit is regarded not as goods lent for a time without payment but as the amount due for those goods. If Mr. X lets me use his goods for three months without payment in one instance and Mr. Y lends me the money to buy Mr. X's goods in another instance the effect is the same. The supplier is said to be "carrying" his customer.

Bank loans at a rate of interest lower than the return made on the money borrowed also give the company earning power. It cannot be too often repeated that the business of a bank is not to provide working capital for its customers, but in practice the banks do this.

In estimating profits and earnings *all* sources of earning power must be taken into account.

Invested capital, in other words, is only one factor in the index of probable earnings, although it is the main factor.

The three most important means of estimating earnings are:

- (1) Dead reckoning.
- (2) Past experience.
- (3) Comparison with other companies of similar scope.

**Dead Reckoning** is the name given to the ordinary routine of business estimating. Probable demand at known prices compared with known costs and probable expenses make a simple equation. The "imponderable" here is demand. Advance business in the form of orders in hand not subject to likely cancellation or bad debts is hard to calculate. Probable demand is really an aggregation of such advance business plus the forecasts of the sales department. Expenses are also liable to fluctuate, both in the form of sales expenses and enforced overheads such as rating or taxation.

Past experience works in with dead reckoning. With a new company exploiting a new field it cannot, obviously, apply, but with businesses that are expansions or continuations of going concerns or with businesses that are the result of mergers it is extremely valuable.

Comparison with rival businesses is a useful index to the probable scope of earnings, but it must be skilfully made. Difference in financial structure, in personnel, in equipment have all to be taken into account.

Most businesses are able to calculate fairly accurately in normal times and within a single balance-sheet period their profit ratio on the assumption that labour costs, taxation, and fixed overheads will not be subject to sudden change. No business can depend upon volume of demand, for here so many things intervene. Change of vogue, the acceleration of salesmanship among rival and competitive firms, the depletion of purchasing power among customers caused by events outside human pre-  
vision, such as a slump in the United States or a threat of war—all these have to be guessed rather than deduced. Even the optimism of salesmen can be a factor that throws estimates wildly out of true.

But however desperate the attempt to reach a reasonable estimate, it must be made. And—let it be repeated—it must be made conservatively. A finance plan based on a too optimistic estimate of earnings is far more dangerous to the business than one made on a too pessimistic estimate. The too optimistic estimate may cause the

need to seek temporary finance at an awkward moment: the too pessimistic estimate at worst will only embarrass the company with funds for which temporary employment has to be found.

Closely allied to the estimating of earnings is the wider task of general business forecasting and business budgeting.

I have spoken above of events outside the scope of human prevision which affect demand. The phrase was a purposeful exaggeration. There are very few events that cannot by the exercise of industry and common sense be foreseen—industry in gathering the data and common sense in deducing from them whatever lessons they hold. The prime duty of the executive head of a business is to consider the world at large in its relation to his particular enterprise. If he fulfils this duty he can almost always detect a trade trend at its inception.

To take some ordinary examples. The head of a wholesale clothing enterprise would be foolish if he did not, either himself or through deputies, watch not only the fashions which display themselves in the society journals, but also on the stage and on the screen, for these will quickly seep down from the exotics of Hollywood and Paris to the middle-class and working-class streets of British provincial towns. A manufacturer of sweet-meats would be foolish if he did not closely watch the changing moods of women, for sudden interest in "keep fit" campaigns obviously means a coming demand not for luscious chocolates but for body-building sweets of the character of malted-milk toffee.

An alert business will not in this regard be content with its travellers' reports that retailers (or wholesalers) are finding demand for a particular product waning. It will desire to know why as soon as the fall-off shows itself. It will ask whether the decline is in its own products only (which means either faulty quality or faulty salesmanship, which includes publicity) or whether it is in the product itself by whomsoever made, which will imply a change in taste. Similarly, a drift away from a long-established

seasonal trade will be investigated without delay. A season that either tends to grow longer or to shift its opening and closing dates is direct evidence of some trend in demand of which advantage can be taken if it is early detected. These things *do* happen: automobiles have made a season for themselves, greatcoats and rain-proof coats have seen their old season widen out; hard courts have affected sports outfitters' sales.

The data for forecasting is not niggardly. In addition to the sources of information which are personal to the business—such as salesmen's reports—there are many which are general to the community. They include the Board of Trade analysed figures of trade, the similar figures for other countries, and the expert reports of markets given in the technical and financial press.

Such forecasting is, as I have said, closely allied to, but is different from, earning estimating. The short-term estimate of earnings should be checked by the long-term forecasting of trends. When this is done the business has removed itself from the haphazard methods of an old-fashioned small business which merely made as much as it could and sold as much as it could and wondered why it eventually reached Carey Street after perhaps a generation of great prosperity.

## CHAPTER VIII

### BUSINESS BUDGETS

A CAREFULLY-planned financial programme based on as sound an estimate of profits as can be managed gives at least an assurance that waste will be eliminated from the financial control and that the business will not be caught short of funds at a crucial moment or left loaded with too much idle money. But such a programme is not itself sufficient to give the management full control over financial expenditures or to keep in the minds of departmental heads the relation of their departments to finance. Something more is needed, and that something more is a budget.

When a business budget is drawn up it should never be regarded as sacrosanct. It should not be made like the laws of Medes and Persians an unalterable code for the business to follow. Even the National Budget allows for supplementals. In the day-to-day life of business, departments cannot successfully function on rationed finance. There must be latitude.

But having realised that, the business executive can plan his budget with a good heart, knowing that he is preparing in advance a chart from which favourable or unfavourable trade winds may deflect him but which will keep him aware of how near to the rocks he may be driven.

The type of budget needed obviously varies with the kind and size of enterprise. A small company making or marketing products by a simple process for a quick turnover will not need an elaborate budget, any more than it will need an elaborate finance plan. An enterprise that has to employ expensive machinery, complex process and

large bodies of labour will need a correspondingly complex budget.

The first purpose of a budget in business is to ensure in advance that every department will have the finance needed to permit it to co-operate properly with every other department. Advertising campaigns, for example, must link up closely with both the production and sales departments. Each has its own time lag. The advertising manager needs time to plan his campaign, to produce his matter and to place it. The production department must be prepared for the rush demand that may follow the launching of that campaign. Sales staffs need time to prepare the ground for the coming campaign and to follow it up when the first recession of demand occurs.

A business budget in the making differs in no way from a national budget. It comprises an estimate of all the cash that is likely to be available during the budget period and all the payments that will have to be made.

Cash available includes receipts of all kinds, i.e. collection of accounts outstanding plus proceeds from sales with the period itself. Disbursements include the known calls upon the business within the period plus the estimated expenditures. The object of the budget, be it remembered, is to ensure that any need for funds at any stage of the process or of the period will have been foreseen and that funds will be available without having to be sought at expensive moments.

Once the budget is framed, the fall-in of receipts and the making of disbursements must be carefully watched. The budget will—or should—show whether the business will need supplementary resources at any point or whether it can expect to have occasional or final surpluses, and how far the cash fluctuations of one department can be wedded to those of others. But miscalculations of income and expenditure will throw the budget picture out of perspective from time to time, *and such miscalculations are inevitable*. They are those trade winds of which I spoke in an earlier paragraph. The value of the budget at such times is that it indicates exactly where adjustments

of finance can most easily and most cheaply be made, whether internally or externally.

It will be obvious that the finance director (or officer) controlling the budget is at the mercy of his colleagues. It is upon their ability to keep to promise and programme that he relies. If, for example, publicity and sales departments exceed expectations, production will have to be invigorated. If production more than fills its word, publicity and sales may need refreshers.

Similarly, the budget-maker and controller is at the mercy of outside agencies. Bank credit on which he relied may be unexpectedly contracted. An issue may go badly.

These things mean a constant overhauling of the budget. But to suppose that such overhaulings render a budget farcical is to mistake its whole purpose. On our earlier analogy it is as foolish as to suppose that a charted course for a mariner is unnecessary because winds and storms or casualties cause him to change it from time to time.

A well-planned budget is of use beyond the control of its own period. It indicates also the sound programme to be followed on long-term expenditure.

In this regard I cannot do better than quote again from an American expert, Henry F. Hoagland:<sup>1</sup>

'The trade mark of budgets should be a huge question-mark. The whole purpose may be stated in these words:

What?

Why?

How?

When?

Any official or departmental head who is constantly faced by these questions, when he attempts to defend his proposals and his programmes, will give more careful attention to their formulation and justification than if he were permitted to conduct his department on the basis of inspiration and hunch....

Careful budget-makers will demand answers to several questions

<sup>1</sup> Hoagland: *Corporation Finance*. (McGraw-Hill Book Coy.).

which may cause future embarrassment if not met in advance. Among the more important are the following:

- (1) Will the additional profits justify the expenditure?
- (2) If additional capacity is needed, is the proposed plan the best means of supplying it?
- (3) Can present investment in plant and equipment be utilised to better advantage?
- (4) Is now the proper time to undertake the expansion programme?
- (5) Is new financing necessary, and if so, can it be arranged advantageously?

The business budget, I repeat with emphasis, should not become a business fetish. It is an aid to the control of finance, not a magic formula which relieves the controllers of finance from responsibility for perpetual decision and fluidity. But properly used it will ensure that no finance is raised for which a profitable use is not waiting.

#### NOTE TO CHAPTER VIII

THOSE interested in the technique of business budgeting are advised to consult a valuable lecture delivered to the Chartered Accountant Student Society of London and reprinted in the Joint Transactions of that body for 1936. In that lecture Mr. F. R. M. de Paula, O.B.E., F.C.A., said:

"There is nothing serious or complicated about such a system. In fact, it is extremely simple. It merely represents setting up a system for the purpose of estimating what results next year's profit and loss account and balance sheet are likely to show.

To be of value to management, these estimates must be reasonably accurate and therefore great care and sound judgment are required in framing these forecasts and the system must be such that no known factors are overlooked.

As regards the period of the budget, this depends upon the nature of the business. Some concerns can budget a year ahead or even longer, whereas others can only budget for two or three months ahead.

However carefully the budget may have been prepared, events will rarely work out exactly according to the plan. There are many contingencies impossible to foresee, which may drastically affect the results, such as war, weather, fashion, price wars, booms, slumps, strikes, tariffs, exchange restrictions, etc. It is necessary, therefore, for the budget calculations to be reconsidered and revised periodically.

In the case of our company, we budget for a year ahead and revise quarterly. This means that at the quarterly revisions the whole of the forecasts for the coming year are reconsidered and recalculated.

Our financial year is January to December, and our No. 1 Budget is submitted in the first month of the year, namely January.

The No. 2 Budget is submitted in May, when, of course, we have available the ascertained results for the first quarter.

The No. 3 Budget is submitted in August when the first half-year's accounts are available.

No. 4 Budget, the final revision, is submitted in November when the first nine months' results are known.

I suggest that the year's budget should be subdivided into monthly or quarterly periods, so that during the course of the year the ascertained results may be checked against the budget forecasts. This procedure is most valuable for checking the position during the course of the year, and greatly increases the control of operations and finance.

During the course of the year the actual position should be checked month by month against the budget pre-determined positions.

Under our system the budget is split up as follows.

- (a) Production budget
- (b) Trading and profit and loss budget
- (c) Capital expenditure budget
- (d) Finance or cash budget
- (e) Balance sheet budget

Each company or unit within the combine submits its budgets in this form and the whole of these individual budgets are combined into a master budget for the whole group of companies.

## CHAPTER IX

### SURPLUSES AND RESERVES

EVERY tyro in business knows that a balance sheet is not, and cannot be, a true picture of the business. It is only an instantaneous snapshot of the books of the company at a given date. Between the date of one balance sheet and the next the business goes on, sometimes having a surplus of funds and sometimes having a lack. In earlier chapters we have discussed ways of filling financial gaps. What happens when an enterprise finds itself with more funds than it immediately needs?

Funds come into the treasury in various ways. Current earnings that await a distribution date, current earnings that are to be withheld from distribution, a new issue that pours more money in than can be immediately expended, the sale of assets that are not to be replaced, deposit accounts in behalf of employees, accumulated funds waiting date of tax payments—all these mean responsibility. They can, of course, be left on deposit, on nominal or no interest, but idle funds are irksome to a sound business mind. The ideal method of employment is in some short-term investment in which the capital value of the temporary surplus cannot shrink. There are many sound enterprises which will take such short-term surpluses as deposits—building societies and the like being the chief.

Good commercial paper offers another field. For longer terms municipalities not infrequently offer a temporary resort for unwanted funds, not through the loans that form public investments but through those other loans for which borough treasurers advertise or which they are glad to arrange, matching their temporary

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~~need for funds with the lender's temporary need to provide them.~~

*In normal times the bill market can absorb short-term money, but the arrangements are not always easy for small or new enterprises.*

Investment in gilt-edged securities on the open market breaks the canon that liquidity and security are the first essentials. The gilt-edged market is capable of severe falls. But, although by tradition and stock-market rule you cannot "sell gilt-edged short," it is possible to cover such purchases. If the yield is enough to compensate for buying and selling charges, such a double operation is both possible and useful.

Whatever employment is found for temporary surpluses, however, it MUST conform to the two principles of liquidity and security. These are the first and last qualities needed, and yield must never be allowed to overshadow them.

A company with long-term surpluses at its command should not permit the money to burn holes in its pockets. All temptations to acquire assets that are not demanded by the purely business side of the enterprise should be set sternly aside. The absorption of competitive businesses, the purchase of stocks or of equipment, the use in any way of money in hand is far more often dictated by the presence of that money than guileless shareholders suppose. The question to be asked is not "What can we buy with this supply of cash?" It is, "What does the business need, with what can it not do without, now that funds are available?" The possession of idle funds is no crime, if the use of those funds means undue risk or extravagance.

The employment of temporary surpluses, no matter how long a period of time the word "temporary" may cover, should never be confused with the investment of reserve funds. The two things are totally different.

Reserves are those surpluses which are not expected to be used, but are provided against contingencies which may compel their use. They are, in fact, defined in

**Table A of the Companies Act of 1929, clause 93 of which reads:**

The directors may, before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for equalising dividends, or for any other purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit.

The true reserve of the company is the amount by which the assets exceed the sum of the paid-up capital and liabilities, but what constitutes the real surplus of assets may be argued. But it is not with the "true reserve" that the directors of a company have to deal.

Their purpose is nothing more or less than the ordinary citizen's purpose when he decides what amount of his income he should spend and what save.

What proportion of earnings is to be distributed and what proportion put to reserve must depend upon each individual board of directors, which must also decide how reserves once separated from distributions are to be allocated.

The handling of reserves is one of the most difficult tasks of business. The late S. S. Dawson, as a leading authority on accountancy, wrote very soundly that:

The multiplicity of terms in use in connection with this subject is unfortunate, and the indefinite character of the nomenclature is confusing and misleading. Amongst the terms used are *reserve*, *reserve account*, *reserve fund*, *margin*, *surplus*, and *rest*. As a consequence, elaborate distinctions have been drawn by the respective adherents purporting to show the meaning of the various expressions in an endeavour to justify their continued employment. Some contend that profits earned but withheld from distribution so that they may be employed in the ordinary way of business of the concern which earned them are capitalised profits and not a *reserve*; and, further, that the term *reserve fund* should only be used where the sum in question is specially invested in "outside securities."

Others have expressed the opinion that the word *reserve* is rightly applicable to any of the general resources of a concern, even including a part of the paid-up capital, so long as such resources are in cash or readily realisable securities; but it is more generally contended that a *reserve* must necessarily have its origin in profit of some form or other, whether from carrying on the business of the concern in question, from premiums upon the issue of shares, or loan capital, or otherwise. It is certainly a fact that in the majority of cases a *reserve* has its origin in profits, but whether this necessarily implies that a concern which claims to possess a *reserve* must possess a sum of undistributed profits, or the converse, *viz.* that possession of undistributed profits is of itself evidence of the existence of the *reserve*, is a matter of opinion upon which there are different views. . . .

The mere withholding of distributable profits from shareholders does not of itself create a *reserve asset*; the assets so withheld, or their equivalent, must already exist in, or else be subsequently placed in, a state of preparedness in order to constitute a true *reserve fund*.

The reservation of profits which might legally be distributable is one act; the creation of a *reserve*—an asset held as an hostage for contingencies—is distinctly another.

In previous Companies Acts the varieties of reserves were stated with more detail than in Table A of the Act of 1929. They were recognised as:

A *reserve against contingencies*.

A *reserve for the purpose of equalising dividends*.

A *reserve for the purpose of repairing and maintaining the property of the concern*.

The contingencies are, of course, many, not least being the need to provide against future depreciation of capital assets and for working capital in excess of the legal capital upon which dividends are payable to shareholders.

However reserves are allotted, whether to dividend equalisation or to general or other specific purposes, the test of a true *reserve* is always that it be *something not in use* but ready for future use. By this test it would seem that a *reserve* invested outside the business is sounder than one employed in the business, but circumstances must always govern a decision in this matter.

Whether internal or external, a reserve should be the subject of constant care. The shrinkage in the value of the asset which represents the reserve, or the freezing of that asset from its original liquidity are the main dangers to be watched for and guarded against.

Closely allied to open reserves are hidden reserves, which are usually assets that appreciate without that appreciation being written up in the books and on the balance sheet. Some financial institutions, for example, make it a rule that any gilt-edged holdings shall be written down if they fall but not written up if they rise.

There is nothing wrong or immoral about the creation and conservation of hidden reserves—in some cases the articles expressly provide for them—but their use may be dangerous unless it is made plain. To secrete profits in a good period may be generally commendable, with the reservation that it baulks the ordinary shareholder from judging the true value of his shares, but to bring back those profits in a bad period without permitting it to be known that they differ from current earnings may become definitely illegal, as it was shown in the case of the Royal Mail Company.

Reserves, however created, are undivided profits and can be capitalised if it is decided that the reserve is larger than the enterprise needs. Methods of capitalisation of reserves are many. If issued shares are only partly paid up a bonus can be declared out of profits and a call made payable at the same date. The more usual method is to issue paid-up bonus shares to the members of the company and simultaneously to carry forward a corresponding amount from reserve to capital account. As paid-up shares cannot strictly be issued unless they are paid up by someone other than the company itself, it is usual to declare a bonus payable out of reserve—free of income tax—so that each member can have an individual right, and this can then be satisfied by the issue of paid-up shares. A bonus issued in the form of paid-up shares, it should be noted, is not income for the purpose of surtax.

## CHAPTER X

### INCREASE OR REDUCTION OF CAPITAL

DURING the history of a limited company it may become expedient either to increase or reduce the amount of its authorised capital.

Section 50 of the Companies Act, 1929, lays down that:

(1) A company limited by shares or a company limited by guarantee and having a share capital, if so authorised by its articles, may alter the conditions of its memorandum as follows, that is to say, it may—

- (a) increase its share capital by new shares of such an amount as it thinks expedient;
- (b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
- (c) convert all or any of its paid-up shares into stock, and reconvert that stock into paid-up shares of any denomination;
- (d) subdivide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the subdivision the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
- (e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(2) The powers conferred by this section must be exercised by the company in general meeting.

(3) A cancellation of shares in pursuance of this section shall not be deemed a reduction of share capital within the meaning of this Act.

(Sections 51 and 52 deal with procedure and penalties, and should be consulted for such details.)

The increase of capital referred to in Section 50 is an increase of authorised—not issued—capital. Unless the new shares are to be issued immediately the increase should not be made, for stamp duty on the new shares is payable as soon as the shares are created.

The usual motive for an increase in authorised capital is the need or the wish to finance some permanent extension or expansion of the business.

It is important to note that the change of capital must be authorised by the articles of the company. If the existing articles do not so authorise, then a special resolution must first be passed amending those articles. The exercise of the power to alter the capital can be authorised by the same resolution that amends the articles.

The resolution for the alteration being passed in general meeting, notice is given to the Registrar of Companies. In the case of an increase in capital this notice and a printed copy of the resolution must be filed within fifteen days of the passing of the resolution. In the case of a reduction or other change a period of one month is allowed and no copy of the resolution need be filed.

It need, perhaps, hardly be said that in drafting the change of capital and the resolution which will permit it, legal advice from the solicitors to the company should be taken. These things are no matters for legal laymen, even though highly trained in semi-legal secretarial practice.

It is important, if the companies' shares are quoted on the Stock Exchange, that as soon as the resolution is passed a notification be made to the secretary of the Share and Loan Department, with copies of the notice of meeting and other relevant documents.

Reduction of capital is generally forced by a loss of assets and exhaustion of reserves, but this is not always so. Very prosperous companies wishing to effect a simplification of their capital structure sometimes find a capital reduction expedient. A reduction is covered by Section 55 of the Act, which reads:

- (1) Subject to confirmation by the Court, a company limited by

shares or a company limited by guarantee and having a share capital may, if so authorised by its articles, by special resolution reduce its share capital in any way, and in particular, without prejudice to the generality of the foregoing power, may—

- (a) extinguish or reduce the liability on any of its shares in respect of share capital not paid up;
  - or
  - (b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost or unrepresented by available assets;
  - or
  - (c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company,
- and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.
- (2) A special resolution under this section is in this Act referred to as "a resolution for reducing share capital."

(Sections 56 to 60, inclusive, should also be consulted for details of procedure and penalties.)

It will be readily realised that two sections of people are affected by a reduction of capital—the shareholders and the creditors. Under Section 56 (2) provision is made to protect creditors against any harm which might be caused to them by the company's paying back to the shareholders paid-up capital or cancelling to shareholders uncalled liability. The creditors entitled to object are those who, on a date fixed by the Court, are entitled to any debt or claim which if that date had been the beginning of the winding-up of the company would be admissible in proof against the company, although the Court has wide discretionary powers of exclusion. Under the Act itself a dissenting shareholder has no right of objection to a scheme of reduction, but in cases tried before the Act it was held that a dissenting shareholder has such right, and even when his objection is not upheld he may be awarded costs against the company where his arguments have assisted the Court to a decision.

When the order of the Court has been obtained it must

be produced to the Registrar of Companies, and a copy of the order and a minute approved by the Court must be filed with him. The resolution for reducing capital does not become effective until this has been done.

The essentials of any scheme for capital reduction are that it should conform to the provisions in the articles and should be such that the general meeting of shareholders will find it acceptable; it should be as simple in form as possible and should, as far as human foresight can ensure, promise to end once and for all the trouble in the company's affairs which make it necessary. Unless the necessity for a reduction is a pure desire to straighten out a too complex capital "set-up," if, that is to say, the reduction is caused by misfortune and loss, the publicity to which it gives rise hurts the company's standing. A repetition of such publicity because of a second reduction within a short period is to be avoided at all costs. It is better to be drastic once, than to suffer two schemes following one on the other.

In reducing capital the benefit of the stamp duty paid can be retained if the resolution for reduction contains powers to the subsequent increase to the original figure. This is a point well worth watching.



## APPENDIX I

### WHAT IS A PROSPECTUS?

#### EXTRACT FROM COMPANIES ACT, 1929

34. (1) A prospectus issued by or on behalf of a company or in relation to an intended company shall be dated, and that date shall, unless the contrary is proved, be taken as the date of publication.

(2) A copy of every such prospectus, signed by every person who is named therein as a director or proposed director of the company, or by his agent authorised in writing, shall be delivered to the registrar of companies for registration on or before the date of its publication, and no such prospectus shall be issued until a copy thereof has been so delivered for registration.

(3) The registrar shall not register any prospectus unless it is dated, and the copy thereto signed, in manner required by this section.

(4) Every prospectus shall state on the face of it that a copy has been delivered for registration as required by this section.

(5) If a prospectus is issued without a copy thereof being so delivered, the company, and every person who is knowingly a party to the issue of the prospectus, shall be liable to a fine not exceeding five pounds for every day from the date of the issue of the prospectus until a copy thereof is so delivered.

35. (1) Every prospectus issued by or on behalf of a company, or by or on behalf of any person who is or has been engaged or interested in the formation of the company, must state the matters specified in Part I of the Fourth Schedule to this Act and set out reports specified in Part II of that Schedule, and the said Parts I and II shall have effect subject to the provisions contained in Part III of the said Schedule.

(2) A condition requiring or binding an applicant for shares in or debentures of a company to waive compliance with any requirement of this section, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.

(3) It shall not be lawful to issue any form of application for shares in or debentures of a company unless the form is issued with a prospectus which complies with the requirements of this section:

Provided that this subsection shall not apply if it is shown that the form of application was issued either—

- (a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures; or
- (b) in relation to shares or debentures which were not offered to the public.

If any person acts in contravention of the provisions of this subsection, he shall be liable to a fine not exceeding five hundred pounds.

(4) In the event of non-compliance with or contravention of any of the requirements of this section, a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance or contravention, if—

- (a) As regards any matter not disclosed, he proves that he was not cognisant thereof; or
- (b) he proves that the non-compliance or contravention arose from an honest mistake of fact on his part; or
- (c) the non-compliance or contravention was in respect of matters which in the opinion of the court dealing with the case were immaterial or was otherwise such as ought, in the opinion of that court, having regard to all the circumstances of the case, reasonably to be excused:

Provided that, in the event of failure to include in a prospectus a statement with respect to the matters specified in paragraph 15 of Part I of the Fourth Schedule to this Act, no director or other person shall incur any liability in respect of the failure unless it be proved that he had knowledge of the matters not disclosed.

(5) This section shall not apply to the issue to existing members or debenture holders of a company of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant for shares or debentures will or will not have the right to renounce in favour of other persons, but subject as aforesaid, this section shall apply to a prospectus or a form of application whether issued on or with reference to the formation of a company or subsequently.

(6) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or this Act apart from this section.

36. (1) A company limited by shares or a company limited by guarantee and having a share capital shall not previously to the statutory meeting vary the terms of a contract referred to in the prospectus, or statement in lieu of prospectus, except subject to the approval of the statutory meeting.

(2) This section shall not apply to a private company.

37. (1) Where a prospectus invites persons to subscribe for shares in or debentures of a company—

(a) every person who is a director of the company at the time of the issue of the prospectus; and

(b) every person who has authorised himself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time; and

(c) every person being a promoter of the company; and

(d) every person who has authorised the issue of the prospectus, shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement therein, or in any report or memorandum appearing on the face thereof, or by reference incorporated therein or issued therewith, unless it is proved—

(i) that having consented to become a director of the company he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(iii) that after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of the withdrawal, and of the reason therefor; or

(iv) that—

(a) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did up to the time of the allotment of the shares or

debentures, as the case may be, believe that the statement was true; and

- (b) as regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy of or extract from a report or valuation of an expert, it fairly represented the statement, or was a correct and fair copy of or extract from the report or valuation; and
- (c) as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or copy of an extract from the document:

Provided that a person shall be liable to pay compensation as aforesaid if it is proved that he had no reasonable ground to believe that the person making any such statement, report or valuation as is mentioned in paragraph (iv) (b) of this subsection was competent to make it.

(2) Where the prospectus contains the name of a person as a director of the company, or as having agreed to become a director thereof, and he has not consented to become a director, or has withdrawn his consent before the issue of the prospectus, and has not authorised or consented to the issue thereof, the directors of the company, except any without whose knowledge or consent the prospectus was issued, and any other person who authorised the issue thereof, shall be liable to indemnify the person named as aforesaid against all damages, costs, and expenses to which he may be made liable by reason of his name having been inserted in the prospectus, or in defending himself against any action or legal proceedings brought against him in respect thereof.

(3) Every person who, by reason of his being a director or named as a director or as having agreed to become a director, or of his having authorised the issue of the prospectus, becomes liable to make any payment under this section may recover contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment, unless the person who has become so liable was, and that other person was not, guilty of fraudulent misrepresentation.

(4) For the purposes of this section the expression "promoter"

means a promoter who was a party to the preparation of the prospectus, or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company.

The expression "expert" includes engineer, valuer, accountant, and any other person whose profession gives authority to a statement made by him.

38. (1) Where a company allots or agrees to allot any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus issued by the company, and all enactments and rules of law as to the contents of prospectuses and to liability in respect of statements in and omissions from prospectuses, or otherwise relating to prospectuses, shall apply and have effect accordingly, as if the shares or debentures had been offered to the public for subscription and as if persons accepting the offer in respect of any shares or debentures were subscribers for those shares or debentures, but without prejudice to the liability, if any, of the persons by whom the offer is made, in respect of mis-statements contained in the document or otherwise in respect thereof.

(2) For the purposes of this Act, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, shares or debentures was made with a view to the shares or debentures being offered for sale to the public if it is shown—

- (a) that an offer of the shares or debentures or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or
- (b) that at the date when the offer was made the whole consideration to be received by the company in respect of the shares or debentures had not been so received.

(3) Section thirty-four of this Act as applied by this section shall have effect as though the persons making the offer were persons named in the prospectus as directors of a company, and section thirty-five of this Act as applied by this section shall have effect as if it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—

- (a) the net amount of the consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and
- (b) the place and time at which the contract under which the

said shares or debentures have been or are to be allotted may be inspected.

(4) Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document aforesaid is signed on behalf of the company or firm by two directors of the company or not less than half of the partners, as the case may be, and any such director or partner may sign by his agent authorised in writing.

## FOURTH SCHEDULE

### PART I

#### *Matters required to be stated in Prospectus*

1. Except where the prospectus is published as a newspaper advertisement, the contents of the memorandum, with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively.
2. The number of founders or management or deferred shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company.
3. The number of shares, if any, fixed by the articles as the qualification of a director and any provision in the articles as to the remuneration of the directors.
4. The names, descriptions and addresses of the directors or proposed directors.
5. Where shares are offered to the public for subscription particulars as to—
  - (i) the minimum amount which, in the opinion of the directors, must be raised by the issue of those shares in order to provide the sums, or, if any part thereof is to be defrayed in any other manner, the balance of the sums required to be provided in respect of each of the following matters:
    - (a) the purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;
    - (b) any preliminary expenses payable by the company, and any commission so payable to any person in consideration of his agreeing to subscribe for, or of his procuring or agreeing to procure subscriptions for, any shares in the company;

- (c) the repayment of any moneys borrowed by the company in respect of any of the foregoing matters;
  - (d) working capital; and
- (ii) the amounts to be provided in respect of the matters aforesaid otherwise than out of the proceeds of the issue and the sources out of which those amounts are to be provided.
6. The amount payable on application and allotment on each share, and, in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, the amount actually allotted, and the amount, if any, paid on the shares so allotted.
7. The number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or are proposed or intended to be issued.
8. The names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of issue of the prospectus, and the amount payable in cash, shares, or debentures, to the vendor, and where there is more than one separate vendor, or the company is a sub-purchaser, the amount so payable to each vendor.
9. The amount, if any, paid or payable as purchase money in cash, shares, or debentures, for any such property as aforesaid, specifying the amount, if any, payable for goodwill.
10. The amount, if any, paid within the two preceding years, or payable, as commission (but not including commission to sub-underwriters) for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in, or debentures of, the company, or the rate of any such commission.
11. The amount or estimated amount of preliminary expenses.
12. The amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment.
13. The dates of and parties to every material contract, not being a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company or a contract entered into more than two years before the date of issue of the

prospectus, and a reasonable time and place at which any such material contract or a copy thereof may be inspected.

14. The names and addresses of the auditors, if any, of the company.

15. Full particulars of the nature and extent of the interest, if any, of every director in the promotion of, or in the property proposed to be acquired by the company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares or otherwise by any person either to induce him to become, or to qualify him as, a director, or, otherwise for services rendered by him or by the firm in connection with the promotion or formation of company.

16. If the prospectus invites the public to subscribe for shares in the company and the share capital of the company is divided into different classes of shares, the right of voting at meetings of the company conferred by, and the rights in respect of capital and dividends attached to, the several classes of shares respectively.

17. In the case of a company which has been carrying on business, or of a business which has been carried on for less than three years, the length of time during which the business of the company or the business to be acquired, as the case may be, has been carried on.

## PART II

1. A report by the auditors of the company with respect to the profits of the company in respect of each of the three financial years immediately preceding the issue of the prospectus, and with respect to the rates of the dividends, if any, paid by the company in respect of each class of shares in the company in respect of each of the said three years, giving particulars of each such class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares in respect of any of those years, and, if no accounts have been made up in respect of any part of the period of three years ending on a date three months before the issue of the prospectus, containing a statement of that fact.

2. If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly in the purchase of any business, a report made by accountants who shall be named in the prospectus upon the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus.

**PART III**

1. The provisions of this Schedule with respect to the memorandum and the qualification, remuneration and interest of directors, and the descriptions and addresses of directors and proposed directors, and the amount, or estimated amount of the preliminary expenses, shall not apply in the case of a prospectus issued more than two years after the date at which the company is entitled to commence business.

2. Every person shall for the purposes of this Schedule be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—

- (a) the purchase money is not fully paid at the date of the issue of the prospectus.
- (b) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus
- (c) the contract depends for its validity or fulfilment on the result of that issue.

3. Where any property to be acquired by the company is to be taken on lease, this Schedule shall have effect as if the expression "vendor" included the lessor, and the expression "purchase money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.

4. For the purposes of paragraph 8 of Part I of this Schedule where the vendors or any of them are a firm, the members of the firm shall not be treated as separate vendors.

5. If in the case of a company which has been carrying on business, or of a business which has been carried on for less than three years, the accounts of the company or business have only been made up in respect of two years or one year, Part II of this Schedule shall have effect as if references to two years or one year, as the case may be, were substituted for references to three years.

6. The expression "financial year" in Part II of this Schedule means the year in respect of which the accounts of the company or of the business, as the case may be, are made up, and where by reason of any alteration of the date on which the financial year of the company or business terminates the accounts of the company or business have been made up for a period greater or less than a year, that greater or less period shall for the purpose of the said Part of this Schedule be deemed to be a financial year.

## APPENDIX II

### PERMISSION TO DEAL

"**PERMISSION TO DEAL**" is governed by Stock Exchange Rule 159 and Appendix 34, here reproduced by permission of the Committee

Rule 159 reads

- (1) Dealings will not be permitted in any New Issue until allowed by the Committee unless excepted from this Rule under Appendix 34*a* or 34*e*
- (2) Dealing in "Results" is not allowed.
- (3) In addition to the powers contained in Rule 163 (2) and (3)<sup>1</sup> the Committee may withdraw or suspend the record, but order that bargains be marked, or withdraw or suspend Permission To Deal in any security for any cause and in particular in the case of a Company which fails to publish a Statutory or Annual Report within the prescribed period or in the case of serious default by underwriters or sub-underwriters in meeting their commitments
- (4) The decisions of the Committee regarding
  - (i) Rejections of applications for Permission to Deal,
  - (ii) Withdrawal or suspension of Permission to Deal,
  - (iii) Withdrawal or suspension of Permission to Record Bargains in accordance with Clause (3) of this Rule and Clause (3) of Rule 163

will be posted in the House and, when ordered by the Committee, communicated to the Exchange Telegraph Company for announcement on the tape

Appendix 34 of the Stock Exchange Rules reads

#### REGULATIONS FOR OBTAINING PERMISSION TO DEAL IN NEW ISSUES

The following documents and particulars should be sent to the Secretary of the Share and Loan Department, when application is made for Permission to Deal:

<sup>1</sup> Rule 163 deals with marking of bargains and the official list and the Committee's powers connected therewith

1. (a) Certificate of Incorporation (in the case of a Company registered abroad notarially certified copy or translation of Certificate of Incorporation and of Bye-Laws), (b) the Certificate entitling the Company to commence business (if required), and (c) Memorandum and Articles of Association and copy or draft of Trust Deed (if applicable).

2. Copy of Resolutions authorising issue.

3. Certified Copy of Agreement relating to issue of Shares credited as fully paid and of any other contracts mentioned in Prospectus.

4. In the case of an issue for cash, copy of Prospectus, Offer for Sale or Circular of Issue, stating all material conditions relating to the flotation of the Issue, and (in the case of a new Company) to the formation of the Company and if publicly advertised, copy of principal London newspaper in which the full Prospectus was advertised. In the case of an issue by Prospectus, Offer for Sale, or Circular, it must be stated whether any Shares are under option and if so at what prices, when such options expire and the consideration (if any) given for such options.

*The London Broker's name must appear on any Prospectus or offer for Sale but this regulation shall not apply to issues by Foreign Governments or Foreign Municipal Authorities.*

5. Specimen (or advance proof) of Allotment Letter, and, if possible, of Scrip and Definitive Certificates. Allotment Letters must be serially numbered and be printed on good quality paper. Any Renunciation Letter attached to an Allotment Letter for fully paid Shares must not be current for a period exceeding six weeks and for partly paid Shares for a period exceeding one month from the date of the final call. When, at the same time as an allotment is made for Shares issued for cash, Shares of the same class are also allotted, credited as fully paid, to Vendors or others for a consideration other than cash, the period for renunciation may be the same as, but not longer than, that allowed in the case of Shares issued for cash. The form of renunciation on Allotment Letters (and Letters of Rights) must be printed on the back of, or attached to the document in question. Split Allotment Letters and Split Letters of Rights must be certified by an Official of the Company.

*Note:*—In cases where an Issuing House or other body or person has purchased an issue of Stock which is subsequently offered to the Public, a certified copy of the Resolution or other document, evidencing that the Purchaser has received due authority to issue Scrip on account of the Seller, must be supplied. If no such

authority has been given, the Scrip must be enframed "Contractor's Scrip." "Contractor's Scrip" may not be issued in cases of issues made by County Councils, Municipal Corporations, or other Local Authorities of Great Britain and Northern Ireland.

In order to facilitate the certification of transfers it is suggested that the Allotment Letters should contain the distinctive numbers of the Shares to which they relate.

6. Letter (a) giving distinctive numbers:

- (1) of shares for which Permission to Deal is being applied for, distinguishing those to be allotted:
  - (c) For Cash;
  - (v) to Vendors or others for a consideration other than Cash or in exchange for Cash;
  - (o) in pursuance of an option.
- (2) giving number of Shares unissued or for which Permission to Deal is not applied for, distinguishing these:
  - (v) allotted to Vendors or others for a consideration other than Cash or in exchange for Cash;
  - (o) under option;
  - (r) reserved for future issue.
- (3) In the case of a further issue stating whether or not the Shares are identical<sup>1</sup> in all respects with existing Shares.

7. Approximate date when Definitive Certificates will be ready for issue.

8. List of allottees or present holders—name, address and holding (when required).

9. In all cases other than Government and Municipal Loans, and issues by Statutory Boards, Companies incorporated by Special Act of Parliament and other similar authorities, whether the issue is made by prospectus or otherwise, particulars of any underwriting or commission must be disclosed and a copy of the underwriting agreement and of sub-underwriting letter, if any, together with (if required) a list containing the names, addresses and descriptions

<sup>1</sup> A statement that Shares are in all respects identical is understood to mean that:

- (1) They are of the same nominal value, and that the same amount per Share has been called up.
- (2) They carry the same rights as to unrestricted transfer, attendance and voting at meetings, and in all other respects.
- (3) They are entitled to dividend at the same rate and for the same period, so that at the next ensuing distribution the dividend payable on each Share will amount to exactly the same sum.

of sub-underwriters and the amount sub-underwritten must be lodged with the Department.

10. An undertaking under the seal of the Company in the following form and to the following effect (printed copies of such undertaking are available in the Share and Loan Department):—

- (1) To split Letters of Allotment and if a "Rights" issue to split Letters of Rights, and to have any such "Splits" certified by an official of the Company.
- (2) To issue the Definitive Certificates within one month of the date of the lodgment of the transfer and to issue balance Certificates, if required, within the same period.
- (3) To notify the Share or Stockholder as soon as a transfer out of his name has been certified by the Company's Officials or notification of Certification has been received from the Share and Loan Department or any Associated Stock Exchange.
- (4) To issue all Allotment Letters simultaneously numbered serially and in the event of its being impossible to issue Letters of Regret at the same time to insert in the Press a Notice to that effect, so that the Notice shall appear on the morning after the Letters of Allotment have been posted.
- (5) To certify transfers against Allotment Letters.
- (6) Where power has been taken in the Articles to issue Share Warrants to Bearer, in the event of the Company deciding to make such an issue: (i) to issue such Warrants in exchange for Registered Shares within three weeks of the deposit of the Share Certificates; and (ii) to certify against the deposit of Share Warrants to Bearer.
- (7) To notify the Share and Loan Department without delay:—
  - (i) Of any changes in the Directorate by death, resignation or removal;
  - (ii) Of any extension of time granted for the currency of temporary documents.
- (8) To forward to the Share and Loan Department:
  - (a) Three copies of the Statutory and Annual Report and Accounts as soon as issued (unless such provision is contained in the Articles of Association).
  - (b) Three copies of all Resolutions increasing the Capital and all notices relating to further issues of Capital, call letters or any other circular at the same time as sent to the Shareholders.
  - (c) Three copies of all Resolutions passed by the Com-

pany in General Meeting other than Resolutions passed at an Ordinary General Meeting for the purpose of adopting the Report and Accounts, declaring dividends, and re-electing Directors and Auditors; and

- (d) To advise the Share and Loan Department by letter of all dividends recommended or declared immediately the Board Meeting has been held to fix the same.

11. In issues made by County Councils, Municipal Corporations or other Local Authorities (hereinafter all referred to as the "Local Authority") the following regulations must also be complied with.

- (1) If Scrip Certificates are to be issued:—

- (a) The denominations must be stated in the Prospectus or the advertisement published under Appendix 34B.
- (b) They must be ready for issue within 21 days of allotment.
- (c) They must bear an autographic signature and there must be supplied to the Committee and (in cases where the official signing is not the Registrar or his officer) to the Registrar of the Stock, specimen signatures of the official or officials of the Borrower, Bank or Issuing House authorised to sign together with the distinctive numbers of the Scrip signed by each official.

- (2) The following letter, signed by a duly authorised official of the Borrower, must accompany the application.

TO THE COMMITTEE FOR GENERAL PURPOSES,  
THE STOCK EXCHANGE

In connection with the issue of £..... Stock of the ..... (Local Authority) I hereby certify that arrangements to the following effect have been duly made:

*If the issue is made by Prospectus.* All moneys received

Bank  
by the ..... — Issuing House under the Prospectus dates

..... on behalf of the ..... (Local Authority) and to which they are entitled will be paid within the following periods to the ..... Bank at ..... being the ordinary Bankers of the ..... (Local Authority) for credit to a special account which has been opened in the name of the Stock:—Moneys paid prior to allotment—3 days after allotment. All other moneys—24 hours after collection.

*If the Stock has been sold outright to a Purchaser.* Allotment letters and Scrip Certificates are not being issued by ..... (Purchaser) on his (or their) own behalf but by or on behalf of the ..... (Local Authority). No such document will be issued until the ..... (Purchaser) has paid to the ..... (Bank) at ..... being the ordinary Bankers of the ..... Local Authority for credit to a special Banking Account which has been opened in the name of the Stock all sums due from the ..... (Purchaser) in respect of the amount certified in the document to have been paid by the holder thereof.

The ..... Bank ..... Issuing House will supply the Registrar:

- (1) As early as practicable with a complete record of the Scrip Certificates issued by them showing in each case the number and other identification mark of the Certificate, the amount of Stock to which it relates and a description of the manner in which it has been authenticated and
- (2) will notify the Registrar immediately payment has been made in full on any Scrip Certificate.

(*Note*:—Where Scrip Certificates are not to be issued the above Clause to be amended so that it applies to allotment letters.)

OR

(In cases where the Bank or Issuing House are also Registrars of the Stock.)

The ..... Bank ..... Issuing House are the duly appointed Registrars of the Stock.

The Registrar will not register or inscribe any person as a holder of the Stock except on surrender for cancellation of fully paid Scrip Certificates for that amount. Provided that if a Scrip Certificate is lost or destroyed the Registrar may not earlier than the first day on which Scrip Certificates can be lodged for registration or inscription register or inscribe a person claiming to be the holder of the lost or destroyed Scrip upon such indemnity being given as may be required.

*Note.*

- (1) If Scrip Certificates are not to be issued amend by substituting "fully-paid allotment letters" for "Scrip Certificates."
- (2) This Clause will not be required in cases where the Local Authority themselves carry out the issue of the allotment letters and Scrip Certificates and the Registrar of the Stock is their Officer. In such a case it will be sufficient to state the fact.

*B.* In the absence of any Prospectus publicly advertised in this Country, or Circular to Shareholders, the Committee will also require an advertisement in two leading London Morning papers giving all material conditions relating to the formation of the Company<sup>1</sup> and to the flotation of the Issue, and headed as under:

"This notice is not an invitation to the Public to subscribe, but is issued in compliance with the Regulations of the Committee of The Stock Exchange, London, for the purpose of giving information to the Public with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information given"

The advertisement must be in the appropriate form I, II, III, or IV herein.

A copy of the advertisement must be signed by or (with the consent of the Committee) on behalf of all the Directors and a signed copy together with a properly certified copy of the Resolution of the Board of the Company approving and authorising the advertisement must be lodged with the Share and Loan Department, except that in the case of Foreign Companies the Committee may dispense with a copy of the advertisement so signed on receiving satisfactory evidence that it has been approved and authorised by a Resolution of the Board of the Company.

A copy of each of the Newspapers in which the advertisement appears must be supplied.

## I

In the case of a Company (other than a Company incorporated by Special Act of Parliament): (a) no part of whose Share or Loan Capital is already dealt in or quoted on the Stock Exchange, and (b) whose Annual Accounts for at least two years have not been

<sup>1</sup> These are given at the end of this Appendix.

made up and audited, the statement required to be advertised by Appendix 34B must contain the following information:

- (1) How, when and where the Company was incorporated.
- (2) The principal objects of the Company.
- (3) In the case of a Company not incorporated in the United Kingdom, whether it has or has not a place of business in the United Kingdom, and the address of the principal place of business in the United Kingdom (if any).
- (4) The names, addresses and descriptions of the Directors.
- (5) The name, address and professional qualification of the Auditors.

*Note.*—Qualification means Chartered Accountant, Incorporated Accountant, etc.

- (6) The names and addresses of the Bankers, London Brokers and Secretary and situation of Registered Office.
- (7) The nominal capital of the Company, the amount issued or agreed to be issued, the amount paid up and, where there is more than one class of share, the rights of each class of share as regards dividend, capital and voting.
- (8) Particulars of any loan capital and the amount issued and outstanding or agreed to be issued, and of the rights conferred upon the holders thereof and the obligations undertaken by the Company in respect thereof, and short particulars of any mortgages and charges subsisting on any part of the Company's assets.
- (9) In the case of Share or Loan Capital issued or agreed to be issued for cash, the price and terms upon which the same has been or is to be issued and (if not already fully paid) the dates when instalments are payable with the amount of all calls or instalments in arrear.
- (10) The provisions of the Articles of Association, Bye-Laws or other corresponding document with regard to:
  - (a) Qualification of Directors.
  - (b) Remuneration of Directors or other similar body.
  - (c) Any provisions enabling the Directors to vote remuneration to themselves or any members of their body.
  - (d) Any provisions with regard to the borrowing powers of the Directors and how such borrowing powers can be varied.
- (11) Particulars of any preliminary expenses incurred or proposed to be incurred.

- (12) A statement setting out clearly the working capital with which the Company started or is to start business, additions (if any) since made and whence derived, and the amount available at the date of the statement for working capital, after providing for all purchase considerations, promotion profits, preliminary expenses, losses, and interest or dividend payments to date, with a statement by the Directors that in their opinion the working capital available is sufficient or, if not, how it is proposed to provide the additional working capital thought by the Directors to be necessary.
- (13) Particulars of the Share or Loan Capital that has been issued or is proposed to be issued fully or partly paid up otherwise than in cash and the consideration for which the same has been issued or is proposed to be issued.
- (14) The names and addresses of the vendors of any property purchased or acquired by the Company or proposed to be purchased or acquired on capital account and the amount paid or payable in cash, shares or securities to the vendor and where there is more than one separate vendor or the Company is a sub-purchaser the amount so paid or payable to each vendor and the amount (if any) payable for goodwill.
- (15) The amount of any cash, shares or securities paid or proposed to be paid to any Promoter and the consideration for such payment.
- (16) Particulars of any commissions, discounts, brokerages or other special terms granted to any persons in connection with the issue or sale of any of the Share or Loan Capital of the Company.
- (17) A statement of the issued Share Capital of any Company acting as Promoter or principal underwriter; the amount paid up thereon; the date of its incorporation; the names of its Directors, Bankers and Auditors; and such other particulars as the Committee think necessary in connection therewith, unless particulars of such Company are contained in the issue of the *Stock Exchange Official Year-Book* current at the date of the publication of this advertisement.
- (18) The dates of and parties to all material contracts with a description of the nature of the Contracts not being contracts entered into in the ordinary course of the business carried on or intended to be carried on by the Company.

- (19) Particulars of any of the Share or Loan Capital of the Company which is under option, or agreed to be put under option, with the price and term of the option and consideration for which the option was granted.
- (20) Full particulars of the nature and extent of the interest (if any) of every Director in the promotion of, or the property proposed to be acquired by, the Company, and, where the interest of such a Director consists of being a partner in a firm, the nature or extent of the interest of the firm.
- (21) A statement of all sums paid or agreed to be paid to any Director or to any firm of which he is a member in cash or shares or otherwise by any person either to induce him to become or to qualify him as a Director or otherwise for services rendered by him or by the firm in connection with the promotion or formation of the Company.
- (22) A statement certified by the Company's Auditors as to the periods (if any) for which the Company's accounts have been made up and audited and particulars of the Share or Loan Capital subscribed and the cash actually received by the Company in connection therewith, also particulars of all dividends paid and amounts carried forward and carried or proposed to be carried to reserve out of the profits of any such periods as shown in the accounts submitted to the Shareholders or in the Directors' Reports attached to the Balance Sheet under Section 123 (2) of the Companies Act, 1929.
- (23) A copy of the last audited Balance Sheet and Profit and Loss Account with a copy of the Auditors' Certificate and any notes or observations in or on the Balance Sheet required to be published by any Act of Parliament relating to the Company.
- (24) If the Company has acquired or is proposing to acquire any business, a report by the Accountants named in the advertisement upon the profits of the business proposed to be acquired for each of the three financial years for which accounts have been made up immediately preceding the date of the advertisement.
- (25) A reasonable time (not being less than seven days) during which and a place in the City of London at which a copy of the Memorandum and Articles of Association of the Company, any Statute or Orders having statutory effect affecting the Company, copies of all material contracts,

Trust Deed (if any) referred to in the advertisement, and copies of all the audited accounts of the Company since its formation with the Auditors' certificates, copies of all other reports and Accounts referred to in the advertisement and all notes or information required to be given by the Companies Act affecting such accounts can be inspected by any member of the Public during usual business hours.

*Note 1.* In the case of foreign Companies, the documents to be offered for inspection will be the documents corresponding to those above mentioned in the case of British Companies, and where such documents are not in the English language notarially certified translations thereof must be available for inspection.

*Note 2.* In cases where it is contended that contracts cannot be offered for inspection without disclosing to trade competitors important information which might be detrimental to the Company's interests, application can be made to the Committee to dispense with the offering of such documents for inspection.

*Note 3.* In any case where information is not given under any of the above heads Nos. 11, 13, 14, 15, 16, 19, 20, 21, the advertised particulars must state that no such payments have been made or explain why the information is not given.

## II

In the case of a Company (other than a Company incorporated by Special Act of Parliament): (a) no part of whose Share or Loan Capital is already dealt in or quoted on The Stock Exchange; and (b) whose annual accounts for at least two years have been made up and audited, the statement required to be by Appendix 34B must contain the following information:

- (1) How, when and where the Company was incorporated.
- (2) The principal objects of the Company.
- (3) In the case of a Company not incorporated in the United Kingdom, whether it has or has not a place of business in the United Kingdom and the address of the principal place of business in the United Kingdom (if any).
- (4) The names, addresses and descriptions of the Directors.
- (5) The name, address and professional qualification of the Auditors.

**Note**—Qualification means Chartered Accountant, Incorporated Accountant, etc.

- (6) The names and addresses of the Bankers, London Brokers and Secretary and the situation of the registered office.
- (7) The nominal capital of the Company, the amount issued or agreed to be issued, the amount paid up and, where there is more than one class of share, the rights of each class of share as regards dividend, capital and voting.
- (8) Particulars of any Loan Capital created and the amount issued and outstanding or agreed to be issued and of the rights conferred upon the holders thereof and the obligations undertaken by the Company in respect thereof and short particulars of any mortgages and charges subsisting upon any of the Company's assets.
- (9) In the case of Share or Loan Capital issued or agreed to be issued for cash within twelve months of the date of the advertisement, the price and terms upon which the same has been or is to be issued, and if not already fully paid the dates when instalments are payable with the amount of all calls or instalments in arrear.
- (10) The provisions of the Articles of Association, Bye-Laws or other corresponding document with regard to the borrowing powers of the Directors and how such borrowing powers can be varied.
- (11) A statement that in the opinion of the Directors the Company has sufficient working capital for the purposes of its business or, if not, showing how the necessary working capital is to be provided.
- (12) Particulars of the Share and Loan Capital that has, within two years preceding the date of the advertisement, been issued or is proposed to be issued fully or partly paid up otherwise than in cash and the consideration for which the same has been issued or is proposed to be issued.
- (13) The names and addresses of the vendors of any property purchased or acquired by the Company or proposed to be purchased or acquired on capital account within two years preceding the date of the advertisement and the amount paid or payable in cash, shares or securities to the vendor and, where there is more than one separate vendor or the Company is a sub-purchaser, the amount so paid or payable to each vendor and the amount (if any) payable for goodwill.

- (14) Particulars of any commissions, discounts, brokerages or other special terms granted within two years preceding the date of the advertisement to any persons in connection with the issue or sale of any stocks, shares or securities of the Company.
- (15) The dates of and parties to all material contracts with a description of the nature of the contract entered into within the two years preceding the date of the advertisement not being contracts entered into in the ordinary course of the business carried on or intended to be carried on by the Company.
- (16) Particulars of any of the Share or Loan Capital of the Company which is under option, or agreed to be put under option, with the price and term of the option and consideration for which the option was granted.
- (17) Either a copy or with the approval of the Committee a summary of the last audited Balance Sheet and Profit and Loss Account with a copy of the Auditors' certificate and any notes or observations in or on the Balance Sheet required to be published by any Act of Parliament relating to the Company.
- (18) A statement certified by the Company's Auditors giving particulars of the Share or Loan Capital subscribed and the cash actually received by the Company in connection therewith within twelve months preceding the date of the advertisement, also particulars of all dividends paid and amounts carried forward or carried, or proposed to be carried, to reserve out of the profits as shown in the accounts submitted to the shareholders or in the Directors' Reports attached to the Balance Sheet under Section 123 (2) of the Companies Act, 1929, in respect of each of the two financial years preceding the advertisement for which accounts have been made up and audited.
- (19) A reasonable time (not being less than seven days) during which, and a place in the City of London at which a copy of the Memorandum and Articles of Association of the Company, any Statute or Order having statutory effect affecting the Company, copies of all material contracts, Trust Deed (if any) referred to in the advertisement, and copies of the audited accounts of the Company for each of the two financial years preceding the date of the advertisement for which accounts have been made up and audited

with the Auditors' certificates, copies of all other Reports and Accounts referred to in the advertisement, and all notes or information required to be given by the Companies Act affecting such accounts can be inspected by any member of the public during usual business hours.

*Note 1.* In the case of foreign Companies the documents to be offered for inspection will be the documents corresponding to those above mentioned in the case of British Companies, and where such documents are not in the English language notarially certified translations thereof must be available for inspection.

*Note 2.* In cases where it is contended that contracts cannot be offered for inspection without disclosing to trade competitors important information which might be detrimental to the Company's interests, application can be made to the Committee to dispense with the offering of such documents for inspection.

*Note 3.* In any case where information is not given under any of the above heads Nos. 12, 13, 14 and 16, the advertised particulars must state that no such payments have been made or explain why the information is not given.

### III

In the case of a Company (other than a Company incorporated by Special Act of Parliament) where Leave to Deal in or a quotation for any of its Share or Loan Capital has already been granted, the statement required to be advertised by Appendix 34B must contain the following information:

- (1) Full particulars of the further Share or Loan Capital in which Leave to Deal is to be applied for, and in particular:
  - (a) In the case of Stocks or Shares the rights conferred as regards income, capital and voting. In the case of Debentures, Debenture Stock, or Securities, the rights conferred as regards income and capital, and full information as to the amount and application of any sinking fund, any right of the Company to redeem before maturity, any rights of conversion, or other similar rights, and in either case the limits of the authorised issue.
  - (b) The price at which and terms upon which such Share

or Loan Capital has been issued or agreed to be issued and whether the same has or has not been paid up in full. If not paid in full, particulars of all payments still to be made with due dates of payment. Where any such Share or Loan Capital has been or is to be issued in whole or in part for a consideration other than cash, full particulars of the consideration received or receivable by the Company for the issue thereof must be given.

- (c) Particulars of any commissions, discounts, brokerages, or other special terms granted to any parties in connection with the issue or sale of any such Stocks, Shares or Securities.
- (d) The dates of and parties to all material contracts affecting the issue of such Share or Loan Capital with a description of the nature of the contract.
- (e) A reasonable time (not being less than seven days) during which and a place in the City of London at which a copy of the Memorandum and Articles of Association of the Company, any Statute or Order having statutory effect affecting the Company, copies of all the contracts and Trust Deed (if any) referred to in the advertisement can be inspected by any member of the public during usual business hours.
- (2) Particulars of any of the Share or Loan Capital of the Company which is under option or agreed to be put under option and consideration for which the same was granted.
- (3) Names of the Directors of the Company.
- (4) Name, address and professional qualification of the Auditors of the Company.
- Note.—Qualification means Chartered Accountant, Incorporated Accountant, etc.*
- (5) Names of London Brokers.
- (6) A statement that further particulars of the Company are contained in the *Stock Exchange Official Year-Book* current at the date of the publication of this advertisement.
- (7) Such other information as in the circumstances of any particular case the Committee think it advisable to require.

#### IV

In the case of Government and Municipal loans and issues by Statutory Boards, Companies incorporated by Special Act of Parlia-

ment and other similar Authorities, the statement required to be advertised by Appendix 34B must contain the following information:

- (1) Full particulars of the Share or Loan Capital in which Leave to Deal is to be applied for and in particular:
  - (a) The rights conferred as regards income and capital, with full information as to the amount and application of any sinking fund, any right of the Authority to redeem before maturity, any rights of conversion, or other similar rights and the security upon which any loan is charged.
  - (b) The price at which and the terms upon which any such Share or Loan Capital has been issued or agreed to be issued, and whether the same has or has not been paid up in full. If not paid in full, particulars of all payments still to be made with due dates of payment must be given.
  - (c) The dates of and parties to all material contracts affecting the issue of such Share or Loan Capital with a description of the nature of the contract.
  - (d) A reasonable time (not being less than seven days) during which and a place in the City of London at which a copy of the Statutes, Orders, or other authorities under which the Share or Loan Capital has been created and issued, with copies of all the material contracts, Trust Deed (if any) above referred to and, where any of the above-mentioned documents are not in the English language, notarially certified translations thereof, can be inspected by any member of the public during usual business hours.
- (2) Particulars of any of the Share or Loan Capital which is under option or agreed to be put under option with the price and terms of option and consideration for which the same was granted.
- (3) Names of Directors (if any) and Auditors (if any) stating qualifications.  
*Note.—Qualification means Chartered Accountant, Incorporated Accountant, etc.*
- (4) Name and address of Secretary (if any) and situation of Chief Office (if any).
- (5) Name of Bankers and London Brokers.

*C.* Where a Broker is instructed to sell on behalf of a Company a further issue of Stock or Shares forming a part of an amount previously created (permission to deal, if necessary, having been given for the original issue) he may obtain permission to deal on presentation of a letter from the Company authorising him to make the sale, or he may sell the Stock or Shares previous to permission being given, provided he makes the sale subject to the permission being granted.

*D.* In the case of Securities of a purely local nature within Great Britain or Northern Ireland or of a Dominion, Colonial or Foreign Issue of which no former Security has been quoted previously on a Dominion, Colonial or Foreign Exchange a Broker may make a specific bargain with the authority of the Sub-Committee on New Issues and Official Quotations, but bargains shall not be recorded in the Supplementary List until permission to deal in the issue has been granted by the Committee.

*E.* In the case of Securities quoted *or dealt in on a Stock Exchange affiliated to the Council of Associated Stock Exchanges* or on a Dominion, Colonial or Foreign Exchange or in the case of New Issues where a previous issue or issues of the same Country, Corporation or Company have been quoted *or dealt in on a Stock Exchange affiliated to the Council of Associated Stock Exchanges* or on a Dominion, Colonial or Foreign Exchange a Member may make bargains provided that a Jobber may not make such bargains out of a market in which he acts as a Jobber.

Such bargains shall not be recorded in the Supplementary List until permission to deal in the issue has been granted by the Committee.

## NOTICE

## RULE 159

Committee Room,  
The Stock Exchange,

19

Dealings in the following Securities as shown in Column (1) have been allowed by the Committee under Rule 159.

In the case of Securities marked with an asterisk dealings will not be permitted until after the issue of Letters of Allotment or Acceptance.

(1) Permission to Deal <i>Granted.</i>	(2) Securities unissued or for which Permission to deal has <i>not</i> been applied for.
(c) Allotted for Cash;	(v) Allotted to Vendors or others for a consideration other than Cash or in ex- change for Cash;
(v) Allotted to Vendors or others for a consideration other than Cash or in ex- change for Cash;	(o) Under option;
(o) Allotted in pursuance of an option.	(r) Reserved for future issue.

## MATERIAL CONDITIONS

These include the following:

The Capital, dividend, voting and other rights conferred by the different classes of shares, and whether or not the shares are fully paid up, and if not, to what extent they are paid up.

The amount of Shares and Debentures or Debenture Stock that have been issued (in the case of Debentures or Debenture Stock, giving the rate of interest payable thereon), the dates and prices at which they have been issued, and the amounts of any underwriting or other commissions that have been paid in connection therewith.

The names and addresses of the Vendors of any property purchased or acquired by the Company or proposed so to be purchased or acquired and the amount payable in cash, shares or debentures to the Vendor, or any other consideration for the sale, and where there is more than one separate Vendor, or the Company is a sub-

purchaser, the amount of consideration so payable or granted to each Vendor.

The amount or estimated amount of the preliminary expenses.

Full particulars of the value and extent of the interest of every Director in the promotion of or the property proposed to be acquired by the Company or in any profit made by the Vendor or Promoter with a statement of the amount paid or agreed to be made to any Director or to his firm or any Company in which he is interested either to qualify him or to induce him to become a Director or otherwise for services rendered by him.

The names and parties to every material contract and the place where they can be inspected.

The Memorandum and Articles of Association (and Trust Deed if the issue relates to Debentures or Debenture Stock) must be open for inspection at the same time and place.

Whether any shares are under option, and if so, at what prices, when such options expire and the consideration (if any) given for such options

Particulars as to qualification and remuneration of Directors.

## BOOK LIST

An exhaustive list of books associated with company finance would fill many pages. The following are easily obtainable and will be found useful to the ordinary student.

*Corporation Finance.* Henry E. Hoagland, Ph.D.

*Corporation Finance.* Edward Sherwood Mead, Ph.D.

*Commercial Management.* Cunliffe L. Bolling.

*Banker and Customer.* S. Evelyn Thomas, B.Com.

*Bankers' Credits.* W. F. Spalding.

*The Banker as Lender.* F. E. Steele.

*The Country Banker.* George Rae.

*How to Form a Company.* Herbert W. Jordan.

*The Routine of a Public Issue.* Oswald M. Brown.

*The Theory and Practice of Finance.* W. Collin Brooks.

*A Concise Dictionary of Finance.* W. Collin Brooks.

*The Accountant's Compendium.* Sidney Stanley Dawson.

*Manual of Secretarial Practice.* Head, Fausset and Wilson.

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# BOOKS TO READ

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## CENTRAL BANKING.

By M. H. DE KOCK, Ph.D. (Harvard), Deputy Governor of South African Reserve Bank, with a Foreword by JOHANNES POSTMUS, Governor of South African Reserve Bank.

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